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Estate & Trust Administration FOR DUMMIES®

DropBooks

by Margaret Atkins Munro, EA,
and Kathryn A. Murphy, Esq.



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About the Authors

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Peggy is the author of *529 & Other College Savings Plans For Dummies*, and the co-author of *Taxes (2005, 2006, 2007, 2008,* and *2009) For Dummies*. She writes a biweekly column on anything and everything to do with money for *The Montpelier (Vermont) Bridge*, and has lectured extensively about taxes and tax-related issues. She's been interviewed on numerous financial and tax-related topics by a variety of national media outlets, including CNN Radio, *Family Circle Magazine*, *U.S. News and World Report*, *USA Today*, *Parents Magazine*, and the Associated Press.

Kathryn A. Murphy, Esq., is an attorney with more than 20 years' experience in the fields of estate planning and administration, including drafting of sophisticated estate plans and prenuptial agreements for high-net-worth individuals. She has also administered many estates and trusts, both large and small, and prepared more than her fair share of estate and gift tax returns.

She is a graduate of The University of Michigan, with an A.B. in English Language and Literature, received her Juris Doctor from Harvard Law School, and is a member of the Massachusetts Bar. Kathy, her daughter, Ana, and their poodle, Danny Boy, have recently returned to her home state of Michigan after more than 20 years in New England. In her spare time she teaches, and is an active member of A Better Life/Moldova, an organization devoted to improving the lives of abandoned children in Moldova (`www.abetterlifemoldova.com`). Kathy is the co-author of *Taxation of Estates and Trusts (Michigan Continuing Legal Education)*, and *Estate and Trust Administration (Michigan Continuing Legal Education)*. She has also lectured on these topics for Michigan Continuing Legal Education. Her writing is an outgrowth of two of her loves: literature and the law.

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Dedication

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To my dear friend Howard, who gave me the idea for this book, even though he didn't know it at the time, and to the memory of his parents Harry and Molly. And to Colin and Jacob, who supported me wholeheartedly as I worked on it.

—Margaret Atkins Munro

To my daughter, Ana, who inspires me in many ways. And to my friend, Peggy, for asking me to join her in this adventure.

—Kathryn A. Murphy

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Last, but certainly not least, our gratitude to Melinda Haskins, who assisted us in so many important ways. This book is as much a testament to her efforts as it is to our own.

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We're proud of this book; please send us your comments through our Dummies online registration form located at www.dummies.com/register/.

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Introduction

This country is aging. Fewer babies are being born, and people are living longer and longer. They're also managing to accumulate more and more wealth. Wealth is relative; two generations ago, a middle-income family owned a house and maybe a car and perhaps even had a little money in the bank. Today, that scenario has become much more complicated. Many who would never consider themselves wealthy now own more than one home and have investments in the stock market, retirement accounts that continue on after death, and debt up to their eyeballs.

With this increased complexity in financial affairs comes a parallel complexity in transferring all these accumulated assets to the next generation(s), either at death or before. In the past, heavy-duty trusts were only for the very wealthy; today, they've become part of the legal landscape for ordinary Americans. And because ours is a do-it-yourself society in so many aspects, that I-can-do-it-myself attitude has carried over into trust and estate administration. Why, many people ask, should they pay someone else to do work that they themselves can perform just as well for a fraction of the cost?

And that's why we've written this book. Between the two of us, we have almost 60 years of estate and trust administration experience, and though we want to think we've seen it all, we accept that some surprises still lurk behind corners, waiting to pounce on us. Still, we've come across some unusual situations in our careers and devised ways to avoid standard pitfalls that await the unwary. We've written this book to share with you some of this accumulated wisdom — to help you to avoid the mistakes that we've made (or narrowly avoided).

About This Book

Estate & Trust Administration For Dummies is the practical reference for those who find themselves thrust into a position of great power and authority (okay, not-so-great power and authority) after they've been appointed as executor, administrator, or personal representative of an estate, or as trustee of a trust. In these pages, you can find advice on what to do — and what to avoid — as you acquire, manage, and dispose of assets that belong to the estate or trust you're administering.

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The world of estate and trust administration is one that can baffle you before you ever get out of the starting gate. You're asked to make decisions literally before you've had the opportunity to process that your friend or family member has died. In those first days after a death, when so much of the world seems like it's at sixes and sevens, you need to decide about the funeral, collect house keys, find the decedent's last will — the list seems endless, and so are the opportunities to have seemingly innocuous items fall through the cracks.

That's where this book comes in. We designed it to explain how you can administer an estate or trust by yourself. It gives you guidelines on what aspects of the work you can undertake on your own, and which areas you really want to ask for an expert to help you.

Simply put, *Estate & Trust Administration For Dummies* is a way to create and follow a road map toward successfully completing your appointed task without ripping out your hair and running into the streets screaming. You can use this book in a variety of ways:

- **As a reference:** Everything's here, whether you have questions about probate, taxes, or how to plan a funeral. The world of trusts and estates can seem complicated, but it's all governed by common sense and rules (and plenty of them).
- **As an advisor:** Some problems may seem unsolvable when you first confront them, but rarely is that truly the case. This book can help you find what questions you need to ask and who you should look to for answers. It gives you solid advice that you can literally take to the bank and lets you know when you would be better served by seeking professional advice.
- **As a little light reading:** We've always found it amazing that anyone could find what we do is boring. It's not! Read on to discover examples of the mildly wacky and truly insane situations we've found ourselves in.

We try to give you as complete information as possible, but trust and estate administration covers a lot of ground, much of it very complex. Still, we have to warn you that every situation is different, and periodically having a professional check your progress in administering any estate or trust is never a bad idea. At best, he or she will confirm that you're doing a brilliant job; at worst, the pro will catch any mistakes you may be making before they have a chance to become really serious.

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Conventions Used in This Book

To help you navigate through this book, we use the following conventions:

- *Italics* emphasize and highlight new words or terms that are defined.
- **Boldfaced** text indicates keywords in bulleted lists or the action part of numbered steps. It also flags the names of specific tax documents so you can find them easily in any discussion.
- `Monofont` is used for Web addresses.

What You're Not to Read

In today's busy world, we know your time is valuable. Of course we'd love for you to read every single word we've written, but we're also realistic and understand that you probably only have time for just the need-to-know information. If you're overwhelmed and want just the essentials, you can safely skip the sidebars without missing any vital info. The sidebars are the shaded gray boxes that delve deeper into a particular topic, or provide examples or interesting info that's slightly off the subject to reinforce and illustrate a concept. If you skip them, you can still understand our point.

Foolish Assumptions

The world of estates and trusts is rife with assumptions, foolish and otherwise. Here are some of the assumptions we've made about you:

- You're not a professional trustee or executor, or a trust or estate administrator already (although even if you are, you should find the information in this book helpful).
- You probably have no idea what you bit off when you agreed to act as either an executor or trustee, but you're eager to find out.
- You're not scared of hard work, both physical and mental, and you're not afraid to delegate. You can do much of what needs to be done in administration yourself, whether it's prying up floorboards in search of the secret money stash or creating a probate account, but you recognize that sometimes paying someone else to do a task you feel unprepared to tackle makes perfect sense.

If you find yourself identifying with any of the above, *Estate & Trust Administration For Dummies* gives you the information you need to start at the beginning and work your way through to the end of any trust or estate.

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How This Book Is Organized

Really, it wasn't difficult to organize this book because it naturally split itself into its component parts: defining a whole lot of terms and types of trusts you may not be familiar with, estate administration, trust administration, and finally transfer tax and income tax issues. The following outlines each part.

Part I: Discovering the World of Estates and Trusts

What we both discovered when we first landed in law offices and started administering estates and trusts was that lawyers, judges, and just about everyone else involved spoke in code. Not only did they use words like *whereas* and *hereunder* in general conversation, but they also threw around terms like administratrix, CRATs, CRUTs, GRITs, and QPeRTS like confetti at a wedding. In this part, not only do we give you the terminology that any executor or trustee worth his or her weight knows, but we also explain who all the players are in estates and trusts (and, in the case of trusts, exactly what games are being played).

Part II: Administering an Estate

Administering an estate is a multistep — sometimes simultaneous-step — operation that requires an eye for detail and sometimes a great deal of patience. In this part, we take you from soup to nuts: figuring out what the decedent owned (and owed), locating the necessary documents, figuring out who inherits, shepherding the estate through the probate process (if necessary), distributing what's left after everyone who has a claim against the estate has been paid, and closing the estate for good. It may seem like a monumental task, but taking it one step at a time, even if those steps go in directions you'd rather not, leads you inevitably to the conclusion you want.

Part III: Operating a Revocable or Irrevocable Trust

Your duties as a trustee are different than the duties of an executor, and the scope of the work is generally less intense, though it takes longer. In this part, we acquaint you with what powers you have as trustee and what duties you're expected to perform. We explore your relationship to the trust's beneficiaries and how to keep it cordial. Plus, we explain how to keep the necessary records and how to terminate the trust after its job is done.

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Part IV: Paying the Taxes

Because the IRS considers trusts and estates separate entities, you have the enviable task of making sure you file all necessary tax returns *(and on time.)* In this part, we walk you through preparation of a simple estate tax return (Form 706), and through the annual income tax returns for trusts and estates (Form 1041). We also explain what you need to know to prepare the decedent's final Form 1040. Finally, we show you how to report to beneficiaries any income you may have distributed to them so they in turn can declare that information on their Form 1040.

Part V: The Part of Tens

What would a *For Dummies* book be without the Part of Tens? In this part, we discuss ten mistakes that are easy to make but, with a little planning, even easier to avoid, and the ten different types of taxes a trust or estate may be liable for. And, in case that wasn't enough, we've also included two appendixes. The first is a glossary. The second is a state-by-state list of basic rules of *intestacy* (dying without a valid last will), plus current state estate tax rules (and where you can find more information and forms, if necessary). Just a quick note of caution: the intestacy rules are far more complex than what we were able to include in the appendix. If you're administering an intestate estate, be sure to consult with the probate court or a qualified attorney as to the disposition of that particular estate.

Icons Used in This Book

The little pictures in the margins are icons. Here's what they mean:



So much to remember, so little time: This icon alerts you to important information you really don't want to ignore.

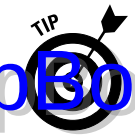


Of course, you want to manage all the administration tasks yourself. But some you're just not qualified for, and others — take our word for it — you really do want to have someone who knows cast a hairy eyeball over. When you see this icon, you've just come across an item we suggest you don't attempt without assistance. Remember, flying without a safety net is unnecessary and usually unwise.



Estate and trust administration can get pretty technical, if you let it (or if you want it to). Check out this icon for specific information regarding rules, regulations, and especially Internal Revenue Code references.

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We've both picked up lots of techniques through hard experience, and we're happy to share them with you. This icon points out administration gems that will (we hope) make your life easier if you can use them. Remember, though, that not every trust or estate will need every tip that comes your way; make sure it applies to your situation before you use it.



In a nutshell, this icon tells you what to avoid when administering a trust or estate.

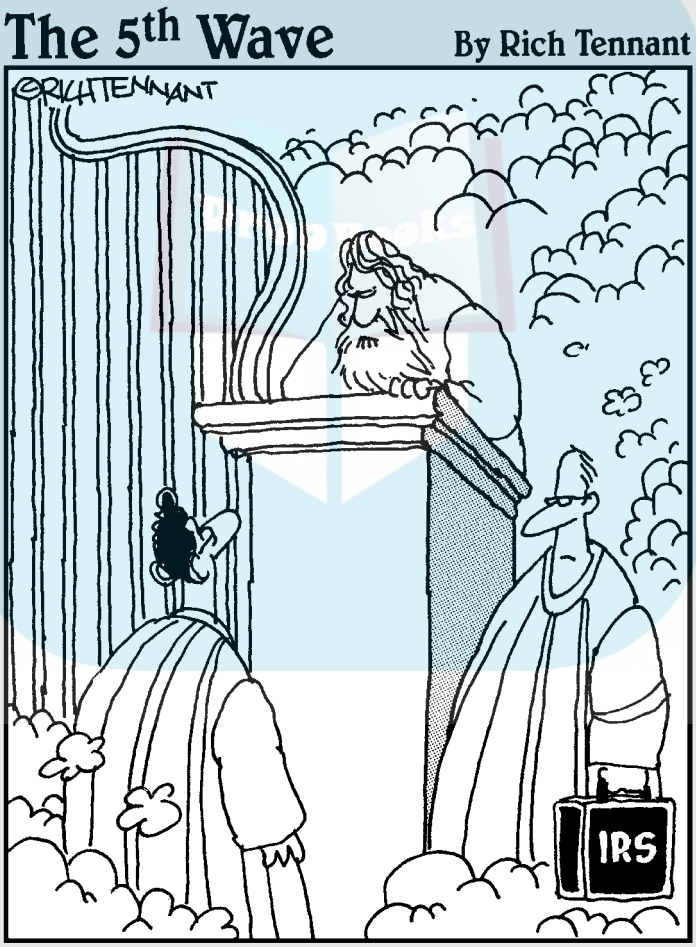
Where to Go from Here

This book isn't intended as a must-read-cover-to-cover sort of tome, nor will you be able to pass a trusts and estates course in law school just because you read it. You may choose to read only what interests you, and ignore the rest. You can get in and get out wherever and whenever you choose. If important information relating to a particular topic is located elsewhere, the text will send you there, so you never need to worry that you're missing basic information because you skipped a portion of the book. Of course, you may discover that it's just a page turner, and every topic fascinates you, in which case you may want to apply to law school posthaste (after you finish the book, of course).

Part I

Discovering the World of Estates and Trusts

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"Death and taxes are for certain, Mr. Dooley, however, they're not mutually exclusive."

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In this part . . .

Have you just found out you've been appointed as an executor, administrator, trustee, or some other sort of fiduciary? Are you baffled by what this all means? Confused by language that everyone else seems comfortable using? We may not be able to explain quantum physics to you, but we're ready, willing, and able to tell you everything you could possibly want to know about estates and trusts. We walk you through the terminology, alert you to who everyone is in relation to yourself, and explain what your responsibilities are. Finally, when you're feeling a little out of your depth (and it happens to all of us, so don't be dismayed), we map out the sources of help available to you.

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Chapter 1

Functioning in a Fiduciary World

In This Chapter

- Becoming comfortable with the terminology surrounding estates and trusts
- Encapsulating estates
- Taking care of trusts
- Preparing and filing tax returns for trusts, estates, and decedents

You may have known for a while that someone close to you has named you as the executor of his or her will, as the trustee of a trust he or she's created, or even as both. That knowledge may make you feel extremely honored while that person's alive and kicking and still able to look after his or her assets.

Those warm and fuzzy feelings may come crashing to a halt, though, the day you hear your friend has passed away, and you're now in charge of the show. All eyes will be on you as you pick up the reins and try to keep this buggy called an estate or trust moving along at a steady clip, while keeping all the promises written down during your friend's lifetime. The responsibility is huge, but so is your potential satisfaction, as you honor his wishes after he is no longer around to appreciate your actions.

This chapter is a jumping-off point for understanding what an estate administrator or trustee actually does: assume control of someone else's affairs in a way that's both sensitive to family dynamics and responsive to family needs. Mishandled, estate and/or trust administration can cause permanent family rifts; on the other hand, competent and careful management helps to keep family memories happy and purpose intact.

Getting a Handle on Who's Involved

Administering a trust or estate isn't rocket science, but it does have its own language. One of the biggest stumbling blocks you run across, especially as you're beginning in your new role, is figuring out who all the players are and what roles they all play. This section points out some important basic lingo you need to know as you start your journey. Refer to the other chapters in Part I for more on your responsibilities as an administrator or trustee.

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Identifying an estate's fiduciaries

Several kinds of *fiduciaries* (people or corporations who hold and administer assets of one person, either living or deceased, for the benefit of another) may be involved in estate administration, depending upon whether a will exists and who the heirs are. You may not even be the only fiduciary; in that case, you and the other(s) must act in unison. And one person or group can fulfill multiple fiduciary roles, such as when one person is named both executor and trustee. The following are types of fiduciaries you may be named:

- **Executor:** The *executor* is the person named in the will to "execute" the will — to carry out the wishes of the person making the will, including disposing of the property according to the will. A female executor is sometimes referred to as an *executrix,* though we don't make this distinction in this book. A named executor may decline to act, although we hope this book gives you the confidence to embrace the role.
- **Administrator:** The *administrator* is a person appointed by the probate court to administer the decedent's estate when the decedent left no valid will. A female administrator may be referred to as an *administratrix*.
- **Personal representative:** The *personal representative* is a general term for both the executor and the administrator. In some states, this term is used in place of executor or administrator.
- **Guardian:** A *guardian* is the person appointed by the probate court to take care of the person and the property of another person who is considered incapable of taking care of his or her own affairs because of his or her age (usually a minor) or for other reasons such as mental illness, mental retardation, physical incapacity, or illness.
- **Conservator:** Similar to a guardian, but with less restrictive rules than those for a guardian. For example, the probate court may appoint a conservator for someone who can't properly care for his or her property due to mental weakness or physical incapacity, for a person missing in action or a prisoner of war, or for a mentally retarded person.



A probate court rarely appoints a conservator for an estate, especially if you've already been appointed as executor or administrator; however, you may find yourself dealing with an already-appointed conservator of an estate beneficiary. Remember, just because you're all working with the same set of assets doesn't mean you belong to the same team. As executor or administrator, you're only responsible for the property owned by the decedent; a beneficiary's conservator is responsible for the that beneficiary's interest.

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Knowing who the trustees are

A trust, just like an estate, must have a fiduciary heading up its team: in this case, a *trustee*. The trustee of a trust is charged with the task of investing the trust's assets, and balancing the desires of the trust's creator (the *grantor,* also referred to as the *settlor*) with the needs of the *beneficiary* (the person or organization entitled to receive the income earned by the trust's assets) and the wants of the *remainderman* (the person or organization who receive what's left of the trust's assets after the trust period ends). It may sound daunting, but when done properly, everyone should go home happy.



Because balancing these competing interests can be complicated, many grantors choose two or more individuals and/or corporations to act together as co-trustees, jointly filling these roles, assigning general powers to all and sometimes specific additional powers to certain trustees. In order to differentiate between the trustees, trustees often are designated as either *independent* or *family.* This section discusses these two types of trustees. Chapter 3 goes into more depth about the different types of trusts and how they operate.

All by themselves: Independent trustees

Independent trustees, or fiduciaries who aren't named in the trust as either grantor, beneficiary, or remaindermen, can be an important cog in keeping the wheels of a trust running smoothly. Whether they're trusted friends of the grantor or are banks, trust companies, lawyers (or law firms), or accountants (or accounting firms), independent trustees owe their primary allegiance to the grantor, who is relying on them to make decisions that best serve the interest of the trust, rather than that of any beneficiary or remainderman.

Frequently, grantors direct an independent trustee to make all decisions regarding discretionary distributions to beneficiaries, especially if one of the trust beneficiaries is also a trustee. And, in the case of testamentary trusts, the probate court often delegates the power to make discretionary distributions to the independent trustee alone so as to remove any semblance of self-serving from a trustee who also has a beneficial or remainder interest in the trust.

For example, one of us acts as trustee for a testamentary trust where the decedent's widow (who is the income beneficiary) and two children (the remaindermen) are also trustees. Only the independent trustee may make decisions regarding distributions of principal to the widow or the children. Distributions to the children prior to their mother's death require either the consent of the independent trustee or the probate judge.

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No independent trustee assumes the responsibilities lightly. As a result, expect to pay for their services, unless the independent trustee is a close friend of the grantor, who may be willing to perform this service out of long friendship and the goodness of her heart. Banks and trust companies most likely have pamphlets that list how they calculate their fees; because they probably have active custody of the trust assets, they usually collect their fees automatically from the trust. Non-institutional professional trustees such as attorneys and accountants bill you for their services. They may charge based on their normal hourly rates, but they're more likely to calculate their fees based on a percentage of the market value of the assets of the trust as well as a percentage of income collected.

Trusts that mandate an independent trustee typically also include a *line of succession* so that if one trustee is no longer able to act, another is in line to take his or her place. If the trust requires an independent trustee, make sure that any vacancies are filled promptly, because it's next to impossible for the trust to function efficiently without one in place.

All in the family: Family trustees

Trust grantors often feel that using only professional trustees (as efficient as they may be) may not account for special family circumstances. In these cases, the grantor may choose to also have a *family trustee*, or a trusted member of his or her family, who knows the players (the beneficiaries and the remaindermen) well and has no difficulty making decisions based on the grantor's wishes.

Family trustees usually have most of the same powers as independent trustees (such as investment powers and the authority to prepare and sign income tax returns and to make scheduled distributions to income beneficiaries), except that their powers over discretionary distributions are often limited if they have any vested interest in the trust as a beneficiary or remainderman.



It's possible for trusts to exist with only a family trustee, although the results are sometimes messy. Somehow, wherever money is concerned, perceptions of appropriate behavior on all sides tend to skew; in our opinion, you're far better off to limit opportunities for self-serving during trust administration by never allowing a family trustee to serve alone. With the addition of an independent trustee, everyone concerned — from the grantor to the trust beneficiary to the trust remaindermen — can be confident that all the competing interests were considered throughout administration and that the trustees made appropriate and fair decisions.



Another bad idea: having family members be sole trustees of a trust established for their benefit. Unless the trustee/beneficiary is only entitled to mandatory distributions of all the income annually (and principal distributions made under very limited circumstances), the assets of the trust can be included in the trustee/beneficiary's taxable estate at the time of his or her

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death, even though the trust property would never be included in the probate estate. If there's also an independent trustee, the grantor can give far more flexibility to that trustee to make distributions of income and principal to the beneficiary, and the trust assets still won't be included in that beneficiary's taxable estate upon his or her death.

And, even though the surviving spouse may be the sole trustee of a marital trust for his or her benefit (after all, the property in the marital trust at the time of the surviving spouse's death will be included in his or her taxable estate anyway), in practice, we've seen few trusts where there isn't also an independent trustee, if only for ease of administration. If the surviving spouse is the beneficiary of a trust other than the marital trust, an independent trustee can provide more flexibility in distributions to the surviving spouse without having the trust assets included in his or her estate.

Lining up your team

No matter whether you've just been named as the fiduciary, or you're the fiduciary's trusted advisor, you'll probably have times when you really want someone else to explain your options to you or set out the potential pros and cons of a decision you must make. Creating a team of professional advisors before you need the advice is the best way to ensure that, when the time comes to make those decisions, you're able to ask the advice and move forward in a clear and measured manner. Chapter 4 lists the types of advisors you may want to employ and explains how they can help you administer a trust or estate without your surrendering all the fun to them.

Estate of Change: Delving into Estates

The day a person dies, you're sure to have more on your mind than the fact that you've just assumed a new role — that of the person designated to wrap up the decedent's affairs. And yet even while you're wrestling with your personal feelings about the loss, you're somehow supposed (and expected) to start tossing all the various balls in the air. You may find yourself planning a funeral at the same time that you're creating the estate's calendar, collecting keys to the residence (if the decedent has no surviving spouse), buying the food for the after-funeral *collation* (light meal), and figuring out what the decedent owned and owed.

In this section, we walk you through all the steps of administering an estate. Just remember, when all the advice begins to leave you breathless, prioritizing can mean the difference between keeping your sanity and running screaming into the sunset. (Check out Part II for more info.)

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Changing the status quo

Although losing a friend or loved one may be difficult, you need to realize that the person's status is static. Your loved one is dead; your status, as administrator or executor has also been altered, but that alteration will continue to morph through the process. You're now responsible for the estate and the decedent's assets and liabilities.

Chapter 5 walks you through the first steps in your legal role. We help you to dive into the decedent's affairs, as you try to gain a sense of what the decedent owned, who he or she owed money to, and who inherits what's left. You create a calendar with all the estate's important deadlines listed prominently, and you discover the documents, both ones that were created before the decedent's death and others that you obtain after death, that you need in order to start moving this estate forward.

Probating an estate

Probate, a word that strikes terror in many hearts, is a fairly straightforward process of providing court supervision to your administration of an estate. Probate exists for your protection as executor as much as to protect the interests of the estate's heirs and legatees. With the probate court judge standing between you and the heirs, you have the opportunity to do your job unmolested. And, as you do that job, the judge and the court staff check your steps and help you when you need it, making sure that you're doing everything you should. As the executor of the estate, you'll start the process by filing the decedent's last will, if there is one, and applying for administration. You can't finish until the court tells you that you can, when you file the final account, and it's allowed.

In Chapter 6, you work your way through the probate process, including getting appointed as executor, administrator or personal representative; filing the last will, if one exists; notifying heirs and creditors; and completing the legal documents you're required to file with the court.

Collecting the estate's assets

Most of the fun in administering an estate (at least, we think so), is digging for buried treasure. As the executor, you need to accurately assess all the estate's assets so you can make a plan for the estate. Without knowing what's there, you won't know if you'll be required to file an estate tax return, or what kind of probate administration you'll need to do.

Chapter 7 tells you where and how to dig, including in some fairly unexpected places, and what to do with those assets after you find them. You also

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discover how to value property, including when you can do it yourself and when you're better served to have an expert help you.

Paying expenses and making distributions

Just because the decedent isn't living doesn't mean he or she doesn't still have expenses. After all, the electricity in the house wasn't turned off at the moment of death, and any mortgage on the residence still needs paid. In addition, the new entity, the estate, begins accumulating its fair share of costs, whether for accounting and investment services, or lawn mowing. In fact, the estate expenses may end up looking similar to the decedent's before his or her death. As the executor, you're responsible for making sure that all the decedent's and estate's bills are paid. Chapter 8 takes you through the expenses you may run across, including the funeral arrangements, the first expense most people think about in relation to death.

After you pay all the estate's bills, you're free to pay off everyone the decedent listed in his or her last will (or the heirs-at-law if he or she died without a valid last will). In Chapter 8, you also discover how to slice up what remains of the pie, in what order you make payments, how to transfer property other than cash, and how to mathematically make divisions of property when the dividing line isn't entirely clear.

Tying up the estate's loose ends

Even after you've paid everyone who needs to be paid, you still need to tidy some odds and ends before you can close the estate and move on. Chapter 9 walks you step by step through all the final actions that will bring the estate to a close. You find out what you need to file with the probate court, the IRS, and the decedent's resident state tax authority to obtain the letters releasing you from further responsibility. You also discover all the final flourishes that will bring the estate you've administered so well to its natural conclusion.

Managing a Trust

Unlike an estate, which only exists for a relatively short period of time (we hope), trusts can continue on for decades, or even longer, depending on the terms of the trust and the ages of all the participants. And because you're involved for the long haul, the lists of what you need to do, in the short term and on an ongoing basis are different. This section highlights some of the main tasks you have to do as a trustee. Whether you've just been appointed as trustee or you've been one for a while but still have questions, you can check out Part III for complete answers.

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Comprehending your duties as trustee

When you agree to act for someone as a trustee, more is involved than just signing on the dotted line, and then walking away. You're now obligated to do your best for the grantor in carrying out his or her wishes, as set forth in the trust instrument. The trust instrument clarifies and specifies your duties. Chapter 10 discusses these types of duties. You grapple with the limits of fiduciary responsibility and discover what it means to honor the grantor's intent. And you explore how to invest the trust assets so that you not only protect the trust principal but also produce the income that the income beneficiary has a right to expect.

Putting assets into trust

If you've finally reached the stage where it's time to transfer assets into a trust, either your own or someone else's, you need to know and follow certain rules in order to make a smooth transition from individual ownership to trust ownership. Chapter 11 explains how to smoothly make those transfers, whether during the grantor's lifetime or after his or her death.

Putting the trust to work

After you transfer the assets into the trust, you as trustee have to create an investment plan that balances income production and growth against risk. Remember, the money in the trust isn't yours to play with, so you can't make any ridiculous gambles with it. Still, taking a keep-it-safe-and-in-the-bank approach isn't smart either because the income beneficiary has a right to (and will) expect income from the trust.

Chapter 12 gives you the pros and cons of a variety of investment options, as well as clueing you in to some current investment theories. It also shows you how to factor in beneficiary needs when determining how best to invest trust assets. Finally, it gives you a heads-up as to what sorts of fees the trust will incur — fees that you have to factor into your calculations when you determine how much, if anything, you can pay to the beneficiaries.

Discovering the point of the trust

A trust's purpose, and your mission, is to balance income generation for the benefit of the current income beneficiary (and principal distributions, when permitted) with principal protection for the remainder interest. Chapter 13 is where you unearth the extra information you may want to consider as you handle this balancing act, such as the beneficiary's health, education, or

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other extraordinary circumstances. Figuring out which life events warrant additional distributions may be the trickiest part of trust administration. In Chapter 13, you also discover why many trustees are likened to kindly relatives, as you attempt to uncover all that you can about the income, or current beneficiary (without being accused of stalking).

Compiling and organizing trust records

You've done all the tricky stuff, but you still must track the activity correctly. Keeping records, though not difficult, isn't particularly fun or exciting, so many people get sloppy about it. Our advice to you: Keep 'em neat! Staying on top of your recordkeeping means never finding yourself buried in an avalanche of paper you're not quite sure what to do with. Chapter 14 tells you how to maintain the trust's records with a minimum of fuss and bother.

Bringing the trust to its conclusion

Trusts sometimes seem to go on forever, but the day (usually) eventually comes when all trusts must come to an end. When that day comes for the trust you're administering, you need to know how to tie up all the loose ends neatly, like preparing and filing the final tax returns and accounts and making the final distributions of the remaining income and assets. You've done a great job up until now — it would be a shame to ruin your track record at this late date.

Chapter 15 explains how to terminate a trust with a minimum of fuss and bother. And call us crazy, but for us, life doesn't get much better than when we've received the last assent to that final trust account, the one on which the ending balance is zero!

Paying Uncle Sam

Taxes in estates and trusts can be pretty involved. Why? Because you're not only dealing with income taxes (and we know how much everyone loves to deal with income taxes), but you may also be responsible for preparing and filing **Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return.** This section gives an overview on Form 706 and the estate and trust income tax return (Form 1041), as well as the decedent's final Form 1040. Check out Part IV for everything you ever wanted to know about estate and trust tax forms.

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Compiling the estate tax return

Not every estate is required to file Form 706, but if you're responsible for one that is, dive right into Chapter 16, which takes you on a stroll through the lengthy estate tax return. Although the blank return may seem formidable, you may find that with the help of this chapter and the Form 706 instructions you're able to prepare all, or at least large chunks, of the return yourself. Chapter 17 goes into more depth and walks you through the many schedules associated with Form 706. Give yourself some credit and take a stab at Form 706; you'll probably be surprised by how far you get. Even if you do end up taking this return to a professional, you gain a much better handle on all the assets and expenses of the estate by first attempting it yourself.

Figuring out the income taxes

Whether you are administering a trust or are involved in an estate, you have to file annual income tax returns as long as either entity owns assets that are producing income. If you're the executor of an estate, you may also be responsible for filing the decedent's final income tax return (or maybe even his or her final two tax returns, depending on when he or she died). We have you covered.

Discover how fiduciary income taxes differ from personal income taxes in Chapter 18, and find out what quirks exist for the decedent's final return(s). Armed with a **Form 1041, U.S. Income Tax Return for Estates and Trusts,** in one hand, and this chapter in the other, you can work your way through trust or estate return preparation on a line-by-line basis.

Whipping together Schedule K-1

Tax forms can be intimidating, especially unfamiliar ones. And **Schedule K-1, Beneficiary's Share of Income, Deductions, Credits, etc.**, may seem overwhelming. But it's really not. In Chapter 19, see how the information from Form 1041 translates to Schedule K-1 when you've made distributions to a beneficiary from either a trust or estate. After you figure out how to make the calculations, it almost becomes fun (well, at least for us, but then we're an accountant and an attorney.)

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Chapter 2

Estates 101: Exploring the Ins and Outs of Estates

In This Chapter

- Classifying the estate differently for probate administration and tax purposes
- Knowing what to do regardless of whether the decedent left a will
- Determining who inherits
- Defining the estate for tax purposes

When you're named as executor or administrator of an estate for the first (or second or third) time, you may have some questions as to what, exactly, an estate is, and about the whole probate estate and estate tax process in general. Before you can administer an estate, you need to have a firm grasp of what an estate is. Don't worry, though — you don't have to become an estate and trust attorney. We provide you with the ABCs of estates right here. Consider it your entry-level course to understanding the basics on estates.

This chapter defines many of the terms associated with estates, lays out the process of determining who inherits, and explains the difference between the estate as it's defined for probate purposes and for estate tax purposes. So read on, dip your toe in, or take the plunge — we think you'll have a firmer grasp on estates.

Defining the Estate for Probate Administration Purposes

In order to administer an estate, you want to know what you're administering. Although an estate may appear to be a confusing legal entity, you don't need to be concerned about all the technicalities. All you need to know is that an *estate* is all the assets a person owns at his or her death that are subject to *probate administration* (proving to a probate court that the will is genuine). Chapter 6 walks you through the specific stages of the probate process.

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So what types of assets comprise an estate? Check out the following:

- All assets held in the *decedent's* (deceased person's) name alone.
- All assets the decedent owned as a tenant in common with one or more other persons. A *tenant in common* holds property together with other tenants in common, but none of the tenants automatically inherit the shares of a tenant who dies. Each tenant holds an equal share of the property unless the property title specifies otherwise. Upon the decedent's death, his or her share becomes subject to probate, even though in some states actual title to real estate (if that is what they're holding) passes to the heirs as of the decedent's death.
- All assets payable to the estate either because the estate is the designated beneficiary or the asset has no designated beneficiary, such as life insurance on the deceased and employee benefits.
- Amounts owed to the decedent before death but paid after death, such as the decedent's last paycheck, and other amounts due to the decedent's estate by reason of his or her death, such as an award from a wrongful death lawsuit.
- Household items, jewelry, and other items that don't usually have title (unless the decedent has, in writing, declared them to belong to his or her revocable living trust during life; see Chapter 3 for more on revocable living trusts).

Chapter 7 includes a complete list of assets to look for as executor or administrator, many of which end up in the probate estate for one of these reasons.



If an asset is in the decedent's name alone for convenience only but really belongs to another individual (for instance, if he or she was holding it for a relative who is incapacitated), the person claiming ownership of the property must furnish proof that it actually belongs to him or her. The asset then goes to the actual owner (or his or her representative) instead of becoming part of the decedent's estate for administration or estate tax purposes. For example, Mary is listed as the only signer on her disabled daughter Sue's checking account, which is funded solely by Sue's monthly disability payments. If Mary dies, Sue (or someone acting for her if she is unable to act for herself) must provide documentation that the account and the money in it actually belong to Sue and not Mary. This proof may be in the form of a letter between Sue and Mary mentioning the arrangement, check stubs from the disability payments, or even bank statements showing that all deposits into the account were for Sue, and all payments out were for Sue's benefit. After that documentation is in order, you have the proof you need to exclude this particular bank account from Mary's estate, both for probate and tax purposes.

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Most assets that are subject to probate administration come under the supervision of the probate (or equivalent) court in the place where the decedent lived at death. The one exception to this rule is real estate. You must probate real estate in the county and state in which it's located. If the estate you're responsible for has real estate in another jurisdiction, including out-of-state real estate, you unfortunately need to have *ancillary* administration (separate probate of the property in the jurisdiction where it's located), in addition to probate in the decedent's state of residence. See Chapter 6 for more on determining domicile.

Will Power: Understanding How a Will (Or No Will) Affects an Estate

Whether or not the decedent left a will determines what form of probate you undertake, and this section gives you a look at the effect of (not) having a will. A will requires you to file a petition with the probate court to have it admitted to probate. The will probably names you as executor, so you don't have to worry about applying for the job. If the decedent didn't leave a will, you file a petition to administer the intestate estate, and other folks who feel they're just as qualified may file a petition as well. If more than one person applies to be administrator, the court decides who gets the privilege. Whether the decedent left a will also determines whether the decedent's wishes (with a will) or state laws in the decedent's state of domicile (with no will) determine whom the assets will go to.

Domicile is the decedent's legal home. It's decided by a combination of factors, including where the decedent lived for more than half of the calendar year, was registered to vote and registered any cars, plus the address he or she used on income tax returns, and many other supporting factors. See Chapter 6 for a complete discussion of domicile.

Dying testate

A decedent dies *testate* if he or she leaves a valid will. The will then undergoes probate according to the laws of the decedent's domicile at the time of death. The purpose of probate is for the court to rule on the validity of the will and supervise the administration of the estate.

What determines the validity of a will? It's based on individual state law. For instance, in most, if not all, states a will writer must be at least 18 years old and of sound mind (know as *having testamentary capacity*). The will must (usually) be in writing (typed or handwritten), and signed by the decedent or another at the decedent's direction and in his or her presence. The following list gives you an overview of some common types of wills:

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- **Holographic:** A *holographic* will is written in the decedent's own handwriting, dated, and signed. It's valid in most, if not all jurisdictions. However, people are more likely to challenge it, and if questions come up about the decedent's intentions (which won't be as clear as in a lawyer-crafted document), the probate court interprets those intentions.
- **Attested:** An *attested* will is usually prepared and typed by an attorney's office and signed by the decedent and two (or in some states three) witnesses who receive no benefit under the will. This is the most typical kind of will.
- **Oral:** An *oral* will (also known as a *nuncupative* will) is a will spoken orally to another person and not written down. A few states recognize them in extreme circumstances, such as imminent death.

Other issues affecting validity are whether the testator was under undue influence from another in making the will, whether fraud was committed against the testator, whether he or she had knowledge of the contents of the will, and whether the will is a forgery. If you as executor are aware of any issues affecting the validity of the will, or have any doubts as to its validity, you should bring this to the attention of the probate court.

Dying intestate

A decedent dies *intestate* if he or she leaves no will. The laws of intestacy also apply if a will turns out to be invalid and the decedent had no prior valid will. (Reasons a will may be declared invalid include forged wills, wills not properly witnessed, a decedent who wasn't of sound mind when he or she signed the will, and fraud or undue influence on the decedent during the writing of the will.) If the decedent died intestate, the laws of the decedent's state of domicile govern both how the estate is administered and who inherits the estate. Check out the next section, "Eyeing Who Can Inherit," for more info on how intestacy affects the estate.

We've both administered estates where the decedent died intestate and we've experienced challenges to the will. Intestacy can be an unfortunate situation because the laws of intestacy frequently don't follow what would have been the decedent's wishes. For example, depending on the decedent's state of domicile, if one spouse dies without a will, the surviving spouse won't inherit everything unless the decedent has no children and, in some cases, other blood relatives with claims to the estate. If minor children are involved, a court-appointed guardian must hold their shares, with the assets supervised by the court until the child reaches adulthood. Of course, often the only one that arrangement works out well for is the court-appointed guardian of the child's assets, who may not have even known the decedent, but now is not only charged with looking after the care and feeding of the minor child but also gets paid (well) by the estate for the privilege.

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The court also decides who will be the guardian of the child's person (who will raise the child) if both parents are deceased, or if the court considers the surviving parent to be unfit. Note that one person can be guardian of both the person and the property of a child, if the court deems that appropriate. Sometimes more than one family member (or family friend) feel strongly that they are the best person to raise the child, in which case things can get messy. Most parents would prefer to make that choice themselves and the court will honor their wishes if the court finds it's in the child's best interest, but we actually know several people who have delayed creating wills because they don't want to face the guardianship question, either because they don't want to offend family members or because they feel they have no good choices for guardians.

Eyeing Who Can Inherit

If you're serving as executor or administrator of an estate, one of the first things you need to do is determine who inherits the estate's assets. If the estate has a valid will, determining who gets what is usually straightforward because the will sets out who the assets go to. However, wills can be fuzzy if they're not well drafted, and sometimes beneficiaries can be hard to track down. If the decedent left no valid will, you have to rely on the laws of intestacy to figure out who gets what.

This section walks you through the people who can potentially inherit something from an estate.

Surviving spouse

If the decedent was married at the time of his or her death, his or her surviving spouse becomes a major player in the eventual disposition of the estate whether or not the decedent had a valid will. If the estate is will-less, the surviving spouse is entitled to a share of the decedent's estate as dictated by the intestacy laws of the decedent's state of residence. When there is a valid will, the surviving spouse has a choice:

- He or she can choose to take any inheritance stated under the will.
- He or she can elect to *take against the will* — that is, to receive the share that he or she is entitled to by statute, known as the *statutory share*, rather than the amount he or she stands to inherit under the will. Generally, the spouse's statutory share isn't as generous as the spouse's *intestate share* (the share he or she would receive if the decedent died without a will), and they are definitely two different animals

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This section takes a closer look at these choices. Appendix B shows you the rules for intestate shares, state by state.



In certain instances, such as when the surviving spouse's own estate is taxable without any additions from the decedent's estate, it may not be in the surviving spouse's best interest for estate tax purposes to accept any inheritance from the decedent. In this case, the surviving spouse should *disclaim,* or refuse by a legal document, any part of either what the decedent left him or her under the will or the spousal portion of the estate determined by the intestate statute. See Chapter 8 for details on disclaimers.

Inheriting under the will

In the most common scenario we see, the surviving spouse chooses to inherit whatever the will provides for him or her in accordance with the decedent's wishes. Most spouses plan their estates together and execute their wills at the same time. They typically have a common purpose in mind: to take care of the survivor during his or her lifetime (along with any children if they're minors). Their plans typically mirror each other's. These sorts of wills are often referred to as *reciprocal*, where each will gives everything (except for bequests of specific personal property) to the other and only after the second death does the property pass out into the wider family.

Taking against the will

Each spouse has the right to leave his or her property by will to whomever he or she wants. To offset that right, the surviving spouse has the right to take an amount allowed by statute rather than the amount, if any, left to that spouse under the will. For a variety of reasons (such as a second marriage where the decedent wants to favor children from a first marriage in his or her will, or if the spouses aren't amicable before the decedent's death), the surviving spouse may get less under the will than he or she would receive by taking his or her statutory share. That's when the surviving spouse may decide to take against the will. See Chapter 6 for a fuller discussion of the spouse's decision of whether to take against the will. Don't forget, this spousal statutory share is not the same beast as the intestate statutory share. Though every state has a spousal statutory share, any *prenuptial agreement* (an agreement signed before marriage — think movie stars, billionaires, and second marriages) or *postnuptial agreement* (an agreement signed after marriage) that the surviving spouse signed that set out or limited the amount he or she would inherit upon the decedent's death, that agreement will govern (and it no doubt waives the statutory share).

Surviving spouse's allowance

Most states have a provision for a very minimal surviving spouse's allowance. For instance, in Massachusetts the surviving spouse has the right to live in the home of the decedent for six months, plus an allowance (rarely more than $1,000) for necessities. If the decedent's spouse is also dead, minor children may receive an even smaller amount (no more than $100 per

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child in Massachusetts). These amounts are intended to help the surviving spouse or children through the estate administration period, but the amounts are so small that people rarely apply for them. See Chapter 6 for more on this provision.

Individuals omitted from the decedent's will

Another group of individuals not included in a will may have a right to inherit some assets in an estate. These individuals, called *pretermitted heirs*, are usually children or *issue* of a deceased child (all persons who have descended from that child, like a grandchild of the decedent). If the will doesn't include them, they may elect to take the share they would have received under intestacy, unless the decedent provided for them during his or her lifetime or it's shown that the omission was intentional. The purpose of this policy is to avoid the unintentional disinheritance of a child or other issue of the decedent.

For example, Robert Kennedy's youngest child, daughter Rory, was born after his death. If in his will, he left bequests to all of his children by name, not naming Rory, she could argue that she was left out by mistake and thus was a pretermitted heir entitled to her intestate share. Of course, the Kennedys had good estate planners, so they would never have named specific children without allowing for ones to be born later, and they used trusts for privacy, so this example is just a what if. See Chapter 6 for more on pretermitted heirs.

No such thing as a free ride: Goodbye, dower and curtesy

Although the surviving spouse's statutory share has largely replaced the old concepts of dower and curtesy, they're worth mentioning. Dower and curtesy (defined in the following paragraphs) have now been abolished in most states, or replaced by dower for both surviving spouses; under the old laws of dower and curtesy, the widower's share was far greater than the widow's.

The definition of *dower* may vary from state to state, but it's typically a provision that gives a widow (now usually defined as any surviving spouse) a *life estate* (the use of, for the rest of his or her life) in a portion of all real estate owned by the decedent at death. Dower has been abolished in many states and greatly altered in others.

Curtesy, on the other hand, is generally defined as the widower's right to a life estate in all the real estate his deceased wife owned at death. Curtesy has been abolished or greatly altered in most states, and replaced in some by dower for both widow and widower. See Chapter 6 for information on dower and curtesy.

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Intentional omissions are generally fairly obvious because most competently prepared wills have a provision stating whether the person making the will (the *testator*) intended to provide for children born after the will was made or for any children or other issue not mentioned in the will. Typically, where there's been a family falling out, you find language in the will stating that this or that child has been intentionally left out (or has been left $1). Sometimes a will contains language stating that a child was left out because he or she has been adequately provided for in his or her lifetime.

The other players: Devisees and legatees

Other people may have a claim to inheriting the assets in a decedent's estate. The decedent may name anyone to inherit under his or her will, subject to the rights we discuss earlier in the chapter. The following are a few technical names for you to ponder while you figure out who all the players are in the estate you're administering.

- **Specific devisee:** A person or entity named to receive specific *real property* (real estate) under a will.
- **Residuary devisee:** A person or entity named to receive all the real property not specifically *devised* (left by will).
- **Specific legatee:** A person or entity named to receive *a legacy* (*personalty*, or personal property disposed of by will).
- **Residuary legatee:** A person or entity named to receive all the personalty not specifically disposed of under a will.

Heirs-at-law

Heirs-at-law are those persons who inherit a person's estate under state statutes of descent and distribution if he or she died intestate (without a will). For example, Massachusetts resident John Done dies without a will, survived only by his wife, Mariah (no children) and great aunt Ophelia, from whom he is estranged. Under the intestacy statute, his surviving wife inherits the first $200,000 of assets, and the rest are split ½ to his wife and ½ to Great Aunt Ophelia. If John had children, his estate would have gone as follows: the first $200,000 to his wife, and the rest split ½ to his wife and ½ to his children. Statutes may vary from state to state, but we lay out the results of all of them in Appendix B.

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Defining the Estate for Tax Purposes

The probate process is intended to ensure the smooth transfer of property from the decedent to a beneficiary where no other means of transferring the property is in place. However, federal and state tax authorities are much more concerned with how much of the decedent's property they can tax and accordingly allow for a much broader definition of what the decedent owned at the time of his or her death. Although the probate estate includes only property in the decedent's name alone or payable to the estate, for estate tax purposes all property owned by the decedent in any form, including jointly or in a revocable trust, and any property payable to any person or the probate estate as a result of the decedent's death, is includible in the taxable estate. And, you may have to deal with more than one type of tax; each tax on the decedent's estate also has a specific purpose. This section takes a closer look at the types of taxes an estate may need to pay. (Chapters 17 through 19 expand on the specifics and what you need to do as an executor with these taxes.)

Transfer taxes

Transfer taxes are taxes on a person's right to transfer property and are levied on the value of property as it passes from one person to another through gift or inheritance. Although these following taxes go by different names (gift tax, estate tax, and generation-skipping transfer tax), they're all part of the same umbrella system of taxing the transfer of property.

Some transfers that are *not* considered taxable gifts include

- **Annual exclusion gifts:** Gifts that are limited to the *annual exclusion amount* (the amount which can be transferred per donee without incurring gift tax per year). The annual exclusion amount in 2008 is $12,000 per donee; that amount is reviewed annually, with periodic increases to deal with inflation. In addition, a husband and wife can split gifts from either of them, so together they can give away $24,000 per donee (or two times the annual exclusion amount) per year without using any of their lifetime exemption.
- **Gifts to a spouse**: You may give an unlimited amount to your spouse, provided your spouse is a U.S. citizen. If your spouse isn't a citizen, the exclusion amount in 2008 is $125,000, adjusted periodically for inflation.
- **Tuition and medical expenses paid for someone else:** Just make sure that you write the checks directly to the school, the hospital, or the doctor. If you make a mistake and write the check to your deserving niece or nephew directly, even if he or she turns right around and pays tuition, that gift isn't unlimited, and you may find you've just made a gift that requires a gift tax return (**Form 709**), or even worse, a gift tax return and a gift tax.

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- **Gifts to political organizations**.
- **Gifts to qualified charities:** *Qualified charities* have obtained tax-exempt status from the IRS.

There is also a lifetime *unified credit* which can be applied against any gift tax in the amount of $345,800 for 2008 and 2009, which shelters $1,000,000 of lifetime taxable gifts. Any use of this unified credit during life reduces the use of the unified credit against the federal estate tax upon death.

Federal gift tax

The *federal gift tax* is a tax on the transfer of property from one person (the *donor)* to another (the *donee*) with no payment (or less than full payment) in return. Watch it, because the gift tax is triggered whether the person transferring the property intended to make a gift or not!

Federal estate tax

The *federal estate tax* (sometimes mistakenly referred to as the "death tax") is a tax on the transfer of property at death. All property the decedent owns or has an interest in at death, in whatever form it's held, is subject to the tax.

Only about 2 percent of estates are actually subject to the estate tax because of an exemption amount (based on the unified credit; see Chapter 16 for an explanation of how the unified credit is determined), which is $2 million for 2008. This amount changes to $3.5 million in 2009. In 2010, the estate tax is abolished for that year only, but it reappears in 2011 with much higher tax rates and much lower limits on gross estates. But keep your eye on the ball, because Congress is still debating (with no actual action as of this writing) about what, if anything, may change in the tax that goes into effect in 2011. See Chapter 16 for more in-depth information about the federal estate tax and what you need to do as the executor.

Generation-skipping transfer tax

The generation-skipping transfer (GST) tax is a relatively new invention, intended to ensure that the federal government gets its slice of the pie each and every time assets move from one generation to the next. As a result of more and more people discovering they may be able to pay less overall transfer tax by bypassing their children and giving property directly to grandchildren (or even better, great-grandchildren), Congress plugged this particular loophole so that the gift tax and estate tax can no longer be evaded at any generational level by skipping a generation on the transfer. And so now rules trigger the GST tax any time a transfer is made that skips a generation, with the exception of transfers made into *irrevocable trusts* (trusts that can't be amended) created before September 25, 1985, which are "grandfathered" from the GST.

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The GST tax doesn't apply to gifts that aren't subject to the gift tax as described above. Furthermore, there's a $1,000,000 lifetime exemption from the GST tax, which can be applied to transfers by gift and at death.

Note: A transfer of property to a grandchild is normally considered a *direct skip* and is subject to the GST tax. However, if that grandchild's parent has already died at the time of the transfer, the transfer is not subject to the GST tax.

If property is left in trust for life for a child, at the child's death there will be one of the following

- An estate tax payable because the child had enough control over the trust that it is considered to be owned by him or her and is included in his or her taxable estate
- A GST tax payable, because the terms of the trust are restrictive enough that the property is not considered to be owned by the child, so the GST tax is triggered because a generation has been skipped.

The GST tax is also applied to transfers to or for an unrelated person who is 37½ years or more younger than the transferor — what the IRS has determined to be the equivalent of skipping a generation.

As you can see, there's just no getting around it — a transfer tax is going to be paid at every generation after you pass the million-dollar exemption.

State estate, inheritance and other transfer taxes

State transfer taxes are in a state of flux due to recent changes in federal estate tax law. Until 2005, there was a credit against estate tax due on the federal estate tax return for state death taxes paid, with the limit on the amount of the credit based on the size of the taxable estate. That credit was abolished as of 2005.

Unfortunately, state death taxes paid may now be taken only as a deduction against the amount of the federal taxable estate, and deductions are never worth as much in your pocket as credits.

Many states had (or still have) an estate tax system which is variously known as a *pick-up, sponge,* or *slack-tax* system, because it is designed to collect tax only on the amount allowed as a state tax credit on the federal estate tax return. Of course, when the federal credit was eliminated, the state estate tax source was also eliminated for the states with this system, causing loss of significant tax revenues. Understandably, a lot of states are unhappy right now, and many of them have, or are now in the process of, enacting new estate tax laws to make up for the disappearance of their estate tax and the resulting lost revenue. See Appendix B.

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In the past, administering an estate where an estate tax was due at the state level but not at the federal level was rare. As state and federal estate tax laws continue to diverge, this scenario will become increasingly common, particularly for estates that may just slide under the baseline amount for federal purposes but won't necessarily be tax free at the state level. Still, the `http://en-us.www.mozilla.com/en-US/firefox/central/`number of total estates affected by these divergent rules should remain small.

Some states have an *inheritance tax*, which taxes the amount inherited by a particular beneficiary, rather than the estate as a whole. The tax rate depends upon the relationship of the beneficiary to the decedent, and the tax is payable by the beneficiary, although some decedent's wills may provide that the estate is to pay all inheritance taxes.

Other taxes

No, you're not out of the tax woods yet, but at least these taxes should be somewhat more familiar to you from your personal tax life.

- **Federal income tax for decedent and estate:** You must prepare and file the decedent's final federal income tax return, as well as an income tax return for the estate for every year it's in existence. The estate income tax return does have some differences from the individual return, all of which are explained fully in Chapter 17.
- **State income tax for decedent and estate:** If the decedent was domiciled (had his or her legal place of residence; see Chapter 6 for more on determining domicile) in a state that has an income tax, you must also prepare and file a final state income tax return for the decedent and an estate state income tax return for each year the estate is in existence. Try saying that three times fast!
- **State intangibles tax:** If your decedent was domiciled in a state which has an *intangibles tax* (a tax on certain intangible assets owned by the decedent, such as stocks and bonds), and if he or she had assets subject to the tax, you must prepare and file the final intangibles tax return for the decedent, as well as returns for the estate (if required). You may also find prior year returns for the decedent that were never filed (this is surprisingly common) and that must be filed in order to close the decedent's estate. You can check with your local probate (or equivalent) court to see whether this is a requirement in your jurisdiction.

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Chapter 3

The Lowdown on Trusts: Identifying the Different Types

In This Chapter

- Understanding the difference between grantor- and non-grantor-type trusts
- Deciding when the trust will start
- Defining revocable trusts
- Looking at the variety of irrevocable trusts
- Grasping charitable trusts
- Comprehending the role of the trust as a qualified Subchapter S shareholder

Trusts come in every size, shape, color, and variety. There are enough different types of trusts for every day of the week and every month of the year. Trusts can give money away, save money, pay only certain expenses, or buy the moon. Trusts can contain almost any type of property for almost any length of time, so long as it's not forever (although almost forever certainly works). And one of the lynchpins of the entire transfer tax system is that every person is entitled to transfer a portion of his or her estate to another person or entity without paying any tax on the transfer.

In fact, the sheer amount of different types of trusts makes the possibilities for their use almost endless. Not to worry though. You don't need to memorize all this information. Just know that this chapter takes you on a tour of some of the more popular types of trusts and trustees and shows you how to determine what type of trust you're holding.

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Differentiating for Income Taxes: Grantor Versus Non-Grantor Trusts

You can slice and dice trusts in any number of ways, depending on the terms and provisions written into the trust. But however you choose to categorize them, all *funded* trusts (trusts that hold assets) are divided into two main types for income tax purposes: *grantor* and *non-grantor*. You must determine what manner of beast the trust you're administering is in order to prepare and file the correct income tax returns in the correct way each year. Remember, funded trusts are taxable entities, and you must make the decision either to file a Form 1041 for the trust, or to declare all items of income and deduction on the *grantor*'s (the person who created the trust) Form 1040. And watch out! Although it's not common, you may come across a third type of trust: the *intentionally defective grantor trust*, which contains elements of both grantor and non-grantor trusts.

All trusts have the following participants: *grantors* (sometimes also referred to as *donors* or *settlors*), trustees, beneficiaries, and remaindermen. (If you're not sure who these folks are, we define them all in Chapter 1.) The determination of whether a trust is grantor or non-grantor depends on the relationship of the person playing each role to the grantor. This section spells out these types of trusts and helps you know how to differentiate between the two so you can be sure that you're administering them correctly and reporting the income on the correct income tax return.

Grantor trusts

Grantor trusts allow the person who creates the trust to retain certain powers over the administration of the trust, including the power to revoke the trust and regain ownership of trust property while that person is living. For example, if the grantor, or his or her spouse during the grantor's lifetime, is also named as trustee, you're looking at a grantor trust. Likewise, if the grantor or the grantor's spouse is an income beneficiary, the trust is grantor. The key to identifying a true grantor trust doesn't rest on the grantor's power to revoke the trust but rather on the grantor's keeping control, however tenuous, over the property inside the trust.

In a grantor trust, the grantor is typically not only grantor but also a trustee; he or she is usually beneficiary of not only the trust's income but also as much of the *principal* (the property funding the trust) as he or she needs at any given time. (To understand the complete distinction between principal and income, check out Chapter 12.) Generally, in a grantor trust, the existence of the trust is ignored for income tax purposes, and the grantor declares all items of income and deduction on his or her income tax return.

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In most cases, the trust doesn't even have its own taxidentification number (TIN, the trust equivalent of a Social Security Number) because the trust doesn't need to file its own tax return.

Non-grantor trusts

Non-grantor trusts are trusts over which the grantor has given up all right, title, and interest in the property funding the trust. Although the trust may be *revocable* (can be dissolved), at least during the grantor's lifetime, the grantor may not terminate the trust; only the trustee, who must be someone other than the grantor, may. In a non-grantor trust, the grantor (and the grantor's spouse), in addition to not being a trustee, also may not be named as a beneficiary or as a *remainderman* (a person or entity who receives what's left of the trust's property when the trust terminates or ends).



Even though a trust, when it's first established, may begin as a grantor trust or an intentionally defective grantor trust (see the next section), at the grantor's death all trusts become non-grantor trusts. If you haven't obtained a tax identification number for the trust prior to the grantor's death, now would be a good time to take care of that. See Chapter 18 for how to obtain a TIN. Remember, come December 31 of the year of the grantor's death, you're responsible for filing a Form 1041 for the non-grantor trust that succeeds the grantor trust in existence up until date of death.

Intentionally defective grantor trusts

In an *intentionally defective grantor trust* (IDGT), the grantor creates a trust that looks like a non-grantor-type trust: The grantor makes an irrevocable gift of property into the trust, sets up the trust for the benefit of his or her children or grandchildren, and names someone other than himself or herself as trustee. The difference is that the grantor retains the right to substitute other property of equal value for the property he or she initially funds the trust with, in order to intentionally create a defect, and the income tax treatment for this trust changes into something that's not entirely a grantor trust but not really a non-grantor trust, either.



In fact, when you're administering an IDGT, you must obtain a TIN and file a Form 1041 every year. On the face of the Form 1041, you get to write the following: "Under the terms of the trust instrument, this is a grantor trust. In accordance with Sections 671-678 IRC, 1986, all income is taxable to the Grantor. Statements of income, deduction, and credits are attached." How's that for lively prose? Before you file the Form 1041 make sure that you attach those required statements. The grantor then includes all those items on his or her personal return.

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A defective grantor trust is frequently used to hold real estate and closely held businesses. Why on earth would anyone want a defective grantor trust? It's an estate-planning strategy that, among other purposes, "freezes" the value of property transferred into the trust for estate tax purposes; having the grantor be liable for the income tax removes the income tax paid from the grantor's estate for estate tax purposes. That's because, unlike the grantor trust income tax rules that make the income includible on the grantor's Form 1040, the property is effectively transferred out of the decedent's estate for estate and gift tax purposes at the time it's transferred to the trust. Gift tax, if any, is paid on the value of the property on the date it's transferred into the trust. No estate tax is due when the grantor dies.

Creating Trusts during Lifetime and after Death

Grantors' reasons for establishing trusts vary, from protecting certain pieces of property to providing an income stream for heirs to trying to establish a framework within which a messy family situation may become manageable. Whatever the reason, a grantor may set up a trust that begins functioning during his or her lifetime, or trusts may be created upon the grantor's death.

By the time you start administering the trust, the distinction between a trust created during the grantor's lifetime or after his or her death is probably moot. Still, you need to know whether the trust is *inter vivos* or *testamentary*. The following section explains the difference between these two options.

Trusts created during lifetime

As they craft their estate plans, many people want to retain the greatest amount of control possible over their estates during their lives and after their deaths. In order to do so, many create inter vivos trusts, which are trusts governed by a legal document other than their last wills. As their Latin names suggest, these trusts are created "among the living" during the grantor's lifetime. So basically because an inter vivos trust is governed by an instrument other than the will, its provisions remain private, unlike the will, which becomes public knowledge after it's filed for probate administration. That's why inter vivos trusts are important to families who have substantial assets or who are in the public eye and don't want everyone knowing what they're worth.

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A grantor may fund inter vivos trusts either during his or her life or after his or her death. If funded during the grantor's lifetime, you the trustee need to check the instrument carefully to see if the trust falls under the grantor trust rules explained earlier in the "Grantor trusts" section, or under the intentionally defective grantor trust rules to determine whether to report the income on the grantor's Form 1040 or on a Form 1041 for the trust. Inter vivos trusts may be revocable (often referred to as *living trusts*) or irrevocable; after the grantor's death, they're all irrevocable.



A grantor often uses inter vivos trusts to remove property from his or her estate, at least for probate purposes (check out Chapter 6 for more on probate). For example, if the trust was treated as a non-grantor or intentionally defective grantor trust during lifetime (see the previous section), and if the property transfers into the trust happened early enough that they clearly were not made in anticipation of the grantor's death, this property is excluded from estate tax calculations. If, however, the trust was treated as a grantor-type trust during the grantor's lifetime, be sure to include all property inside the trust when making estate tax calculations.

Trusts created under a last will

Although the idea of a trust for which no probate court supervision is necessary may seem attractive to you, having the court keeping its beady eyes on a rancorous family isn't the worst idea. And, in our experience, nothing can turn a family situation uglier in a hurry than the death of a wealthy parent or grandparent. In cases where a grantor suspects that life may become unpleasant for his or her trustees after his or her death, choosing a *testamentary trust*, or a trust that's contained in the decedent's last will, over an inter vivos trust can be a wise decision. Testamentary trusts are only funded after the grantor's death and are therefore always non-grantor-type trusts.

Unlike inter vivos trusts, where accounting standards are sometimes lax, testamentary trusts must usually provide the probate court with an annual account, depending on what state you're probating the estate in. Check with the probate court involved to be sure of it's requirements, because trustees who fail in their duty to prepare and file these annual accounts when required may be sanctioned by the probate court, usually with just a slap on the wrist but sometimes with a fine or in very rare circumstances a contempt-of-court citation. Probate accounts are a matter of public record, and anyone with the time and energy to go looking for them, from trust beneficiaries, disinherited heirs, or even newspaper reporters nosing around for some dirt, may access them.

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Grasping Revocable Trusts

Like their names suggest, *revocable trusts* are ones that the grantor can *revoke*, or terminate, at any time prior to his or her death. Whether the grantor creates the trust to avoid probate (a so-called *living trust*) or to shelter the true ownership of property behind an opaque curtain, the terms of the trust remain open to revision, reinterpretation, and outright dissolution by the grantor, up to the day he or she dies.

Revocable trusts of all flavors serve as estate planning tools, so you may run across them because you've set up one yourself, you've been named as a trustee on a living trust, or you're administering an estate, and find one or more different types in the decedent's estate. The following sections point out the most common revocable trusts that you may encounter.

Still breathing: Living trusts

Living trusts, or trusts created and funded during the grantor's lifetime, are an estate-planning technique designed to remove assets from the grantor's estate, either directly to his or her heirs upon the grantor's death or into his or her trust *without* ever setting foot in a probate court. These probate-avoidance trusts almost always begin their lives as revocable trusts and are usually treated as grantor trusts for income tax purposes. Most living trusts are clearly identifiable because the grantor fills all the roles: grantor, trustee, and beneficiary.



If you've created a living trust, your goal should be to transfer as many of your assets as you can into the trust during your lifetime. You may not be able to shift every asset, such as those items you hold jointly with someone. If the joint owner is your spouse, and you both really want that specific property to be held in trust, you may opt to transfer full ownership to one or the other of the owners, or split it into two separate pieces, with each of you retaining half. After ownership is vested in only one name, you may then proceed to transfer the property into the name of the trust.



Either the grantor or someone given the grantor's power of attorney can transfer assets into a living trust. Living trusts also have provisions that handle the incapacity of one trustee and the appointment of a predetermined successor, or a procedure for determining a successor. This means that in the case of the grantor's mental or physical incapacity, provisions in a living trust instrument can enable a trusted friend, relative, or advisor whom the grantor has selected in advance to assume the trusteeship and take over control of the grantor's assets' without the probate court having to appoint a guardian or conservator (see Chapter 2 for more information on guardianship and conservatorship).

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Many living trust instruments are written in such a way that, upon the grantor's death, the trust instrument governing the trust remains the same, but new provisions regarding the trust's administration come into force. A trust designed to continue beyond the grantor's death, becomes *irrevocable* at death, and the provisions contained in the trust instrument can no longer be changed or revoked. This now-irrevocable trust will have new trustees and new beneficiaries (remember, while it was a living trust the grantor was probably also the trustee and the beneficiary), and it will require a new TIN.

Tackling Totten Trusts

Although it's much simpler than a living trust (and involves much less documentation), a *Totten Trust* (some states call it a *payable-upon-death account*) is still an estate-planning technique designed to move assets from the grantor's estate, either directly to his or her heirs upon his or her death, or into his or her trust *without* ever setting foot in a probate court, only this time there's no trust instrument. Instead, with the Totten Trust, the grantor opens a specific bank or brokerage account by using specific, formulaic language, and filling out specific paperwork that the bank or brokerage firm provides. For example, Sue Smith may have $10,000 she wants to give to her niece, Ellen Smith, at Sue's death and not a moment sooner. To do this, she can put the $10,000 into a bank account entitled "Sue Smith, in trust for Ellen Smith." For as long as Sue Smith lives, she can add to this account, take money out of it, or even close it entirely. When she dies, any money still in the account now belongs to Ellen Smith.

With this type of trust, the income earned is taxed to the grantor, and these accounts use the grantor's Social Security Number to report any earnings. No separate tax returns are necessary. Upon the grantor's death, no probate is necessary for the assets contained in the account.



Because a Totten Trust doesn't have a trust instrument, each Totten Trust account a grantor opens has its own paperwork.



Not all states recognize Totten Trusts, and many that do have restrictions and regulations for them. If you're thinking of setting up one or more yourself, check with the bank or brokerage firm before you attempt to use one to make sure that your state honors the payable-upon-death designation and to see what restrictions, if any, apply to this type of account in your state. If your state doesn't honor the payable-upon-death designation, the person you name as the successor will still inherit the property, but only after it passes through the probate court.

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Going incognito: Nominee trusts

One reason grantors use living trusts to transfer ownership of assets from themselves to their heirs is to maintain privacy and keep that transfer from becoming a matter of public record in the probate court. However, placing real estate into that same trust may negate that purpose. Many states require that property held in trust record not only the deed but also the trust instrument at the registry of deeds. If you live in one of those states, don't fear! You may still own property in the name of a trust — you just need a different type of trust.



Nominee trusts are a type of trust designed to hold real estate and only real estate. The trustee for the trust has very limited powers; instead, the beneficiaries actually control what happens in the trust (including whether to sell the property). To prevent the world from knowing who the beneficiaries are, a *Schedule of Beneficial Interest,* which lists the names and percentage ownership of each of the beneficiaries, is attached to the original nominee trust instrument but not to the copy recorded at the registry of deeds. That way, although the names of the nominee trust, its trustee, and the property that's in trust are all matters of public record, the names of the people who actually control the property aren't.

Because nominee trusts are disregarded entities for income tax purposes and don't require separate tax returns, the beneficiaries actually claim any income or deductions that the real estate produces on their personal income tax returns. If the real estate in question is property that the transferor ideally would have liked to place in his or her living trust, he or she can name the trustees of the living trust as the beneficiary of the nominee trust in states that recognize nominee trusts. In other states, a nominee partnership is used instead; the partners are typically the trustees of the living trust.

Understanding Irrevocable Trusts

The real meat and potatoes of trusts are the *irrevocable trusts*, or trusts that grantors have created to hold property where the trust instrument may not be revoked or changed. So what is an irrevocable trust?

- The grantor has given up all right, title, and interest to the assets held in an irrevocable trust, and has also given up any right to terminate the trust.
- The property held by the trust is used for the benefit of the named beneficiaries (or unascertained interests who are defined by the trust instrument).

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- The *remainder interests* (those people or organizations who are entitled to receive what's left of the trust property, if anything, when the trust terminates) in the trust property are clearly spelled out in the trust instrument.

That's what all irrevocable trusts have in common. But because a person can draft trust instruments in many different ways and for many different circumstances, a wide variety of types of trusts fall into this category. The following sections highlight why grantors use irrevocable trusts and some of the most common types.

Making gifts to an irrevocable trust

When a grantor funds an *irrevocable trust* (a trust that the grantor can't change or terminate) with property during his or her lifetime, and the grantor is neither a trustee or beneficiary of the trust, he or she is giving up all right, title, and interest to that property — the legal definition of a *gift.* Depending on the size of the gift, the grantor may have gift tax and/or generation-skipping transfer tax (see Chapter 17) consequences as a result of the transfer.

If the grantor is making a taxable transfer to an irrevocable trust (and by taxable, we mean any amounts over and above the amount of the annual exclusion, which was $12,000 in 2008 and is adjusted annually for inflation), he or she will have to complete a **Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return**, giving the name and taxpayer ID number of the trust, and showing the size of the gift. Unless the transferred amounts are huge, the grantor probably won't actually pay a tax on the transfer; this return, however, becomes part of his or her permanent tax records and, together with any other taxable transfers the grantor makes during his or her lifetime, is included as a part of the grantor's taxable estate, which is, in turn, used to determine the total estate tax due upon the grantor's death.

Married couples may opt to minimize gift tax consequences by so-called *gift-splitting,* where the two spouses each show one-half of the gift on their Forms 709 (you're not allowed to file a joint Form 709), even if they didn't own the gifted property jointly. Splitting gifts between husbands and wives doubles the amount of annual exclusion gifts available to the grantor and reduces the amount of any taxable transfer. For instance, in 2008 the two spouses could transfer $24,000 (2 × the $12,000 exclusion amount), no matter whose assets actually were transferred.

If the transfer is to a trust for the benefit of a *skip person* (your grandchild, a more distant relative, or a nonrelated person who is more than 37½ years younger than the grantor), you also have to complete the generation-skipping part of Form 709.

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Property the grantor gifts irrevocably into a trust keeps the same *basis*, or acquisition cost, and acquisition date as it had in the grantor's hands. Unless the asset has depreciated in value less than the grantor's original basis, in those instances, the basis will be the lower of cost or market value at the time of transfer. This information is crucial in determining whether there's a taxable gain or loss when the trustee disposes of the property. It's best to give these records to the trustee at the time the gift is made, and then the trustee should be certain to maintain good and complete records going forward.

Getting the maximum tax benefit out of dying: Marital trusts

Leaving a trust (or more than one, in many cases) behind for your husband or wife after you die isn't a sign that you don't think he or she can handle your money; instead, it's a crafty tax technique designed to minimize the taxes paid on your estate at your death and also those due and payable after your spouse's death. Welcome to the world of marital trusts, where a funded trust means that the grantor has already died and his or her spouse is still alive.



No matter what type of marital trust you're administering, the value of that trust on the surviving spouse's date of death is included in his or her estate tax calculations after he or she dies. Even though you may have avoided paying estate taxes on it after the first spouse's death, you probably won't avoid paying taxes the second time if the surviving spouse's estate is large enough.

All marriages aren't alike; neither are all marital trusts. You may encounter a variety of options depending on a number of factors, like the size of the estate or whether the spouse surviving is from a second or subsequent marriage.

Giving the surviving spouse free reign: Unlimited marital trusts

In an unlimited marital trust, the surviving spouse is entitled not only to all the net income but also as much of the principal as he or she desires. *Net income* includes interest, dividends, rents, business income, income from other trusts or estates, and state tax refunds (to name several types), but excludes capital gains and the expenses paid from income for administering the trust (like the trustee's and tax preparer's fees).



Unlimited marital trusts, sometimes also referred to as *power of appointment* trusts, contain one of two power appointments:

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- **A general power of appointment:** The trust beneficiary may name anyone he or she designates, including himself or herself, at any time during his or her lifetime or upon his or her death, as the recipient of the trust property.
- **A limited power of appointment:** The grantor designates a group of acceptable appointees (such as the couple's children, grandchildren, or charities).

You typically find powers of appointment in the section of the trust instrument dealing with that specific trust. (A single trust instrument often contains the governing provisions for several different trusts). For example, the spouse's power of appointment will be contained in the marital trust. The powers of appointment can be exercised in the will of the power holder (if it's to be effective upon death) or in a separate document. This trust also contains provisions for distributing the assets if the trust beneficiary fails to exercise the power of appointment, so never fear, the assets don't just sail off into the sunset if the surviving spouse forgets to exercise the power or otherwise ignores it.

Understanding the unified credit

The unified credit is the lynchpin of the combined gift, generation-skipping transfer, and estate tax system. Although the amount isn't the same for all three types of transfers, the theory behind this credit is.

Unlike deductions, which are subtracted from taxable amounts before you calculate the tax owed, credits are subtracted from the actual tax that's been calculated. So, in the case of the unified credit, you first calculate the tax due on the transfer being made and then apply the credit to that tax. If the tax you calculate doesn't use up the whole credit, the remaining credit carries forward to a subsequent year in the case of gift and generation-skipping transfer taxes. In the case of estates, if the tax doesn't require the entire credit, the estate won't owe any estate tax.

The unified credit is a cumulative credit. During lifetime, any amounts the decedent doesn't use carry forward; after death, you subtract whatever amounts the decedent previously used from the total amount of the credit available to the estate. So if Maxine gave away taxable gifts that would have used $250,000 of her unified credit during life, at her death her executor or administrator must subtract $250,000 from the total unified credit available to her estate. If she had an estate of $5 million (including her taxable gifts, which are added back for this calculation) when she died in 2009, the total tax on that amount would be $2,130,800, and the amount of unified credit available for all transfers in her year of death was $1,455,800 (or the equivalent of $3,500,000 of assets in 2009). Because she gave gifts during lifetime that used up $250,000 of unified credit, her remaining credit would be $1,205,800 ($1,455,800 total unified credit available – $250,000 amount of credit used), and her estate would pay $925,000 ($2,130,800 total tax – $1,205,800 remaining unified credit), not the $675,000 it would have paid if she hadn't used any of her unified credit during her lifetime.

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Keeping tighter control: Marital estate trust

The *marital estate trust* may be funded with almost all the deceased spouse's (the grantor's) estate, just like the unlimited marital trust. However, unlike the unlimited marital, the terms of a marital estate trust are typically less freewheeling. You as the trustee may have the discretion to distribute income as well as principal. And the surviving spouse, who is also the trust beneficiary, has absolutely no say over who will get the assets after his or her own death. Instead, the assets are paid directly into his or her estate, where they're included for estate tax purposes.

Reining in the surviving spouse: Qualified terminable interest trust (QTIP)

This trust has nothing to do with cotton swabs. Instead, the *qualified terminable interest trust* (QTIP) beneficiary (the surviving spouse) is entitled to all the net income (paid at least annually) but none of the principal, during his or her lifetime. And, unlike the unlimited marital trust, where the trust beneficiary designates where the principal goes during his or her lifetime or after his or her death, the grantor of a QTIP trust makes that determination in the trust instrument.

Protecting the estate tax exemption: Credit shelter trusts

With the transfer tax system in the United States, every person can transfer part (or all, if the transfer is under a certain size) of his or her estate without paying any tax on that transfer. During life, you're even allowed to make annual gifts (sometimes referred to as *annual exclusion gifts*) that are small enough that they fly under the transfer tax system radar without counting against this nontaxable portion. (In 2008, the rules allowed someone to transfer $12,000 per person without any transfer tax consequences.) But as soon as someone dies, all of his or her assets are added up (including property transferred in excess of annual exclusion gifts) and the total subjected to estate taxes. At this point, whatever portion of that allowable tax-free transfer (also called the *applicable exclusion amount*) the decedent didn't use during lifetime is subtracted from the total estate. This portion of the estate funds the *credit shelter trust* (sometimes referred to as the *bypass trust*), or the trust that holds the amount of assets equal to the remaining *applicable exclusion amount*. Not coincidentally, this is the same value of assets on which the corresponding tax would equal the amount of the unified credit available to the estate if those assets were to be taxed. (For a more in-depth discussion of unified credit, see the nearby sidebar.)

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Lower your estate tax (and make your kids and grandkids really happy)

Funding children's and grandchildren's trusts during lifetime with annual gifts equal to the current *annual exclusion amount* (gifts not subject to the gift tax — the amount was $12,000 in 2008, and is adjusted for inflation in $1,000 increments) is a great way for a grantors to remove assets from their estates, especially if they suspect their estates may be taxable at their deaths. We once shared a wealthy client who religiously gave all the annual exclusion gifts she could to each of her children's and grandchildren's trusts. She lived for a very long time, but when she died,all those $10,000 gifts (the amount of the annual exclusion at the time she made the transfers) had been invested for years, and the total value that was sitting pretty in these trusts far exceeded the size of her taxable estate (which was still huge). Had she waited to fund these trusts until after her death, the available pot of money would have been much smaller because her estate would have paid 55 percent in estate tax.



In order to accurately fund the credit shelter trust, you must first obtain copies of the decedent's most recent gift tax return, which should show how much, if any, of the unified credit the decedent has already used during his or her lifetime. If the decedent wasn't obscenely generous during lifetime, you have the full amount, which translates to $2.5 million for decedents dying in 2008, and $3.5 million in 2009. If the return does include taxable gifts, subtract the total gifts (not the credit assigned to the tax assessed on those gifts) from the total amount of the estate that's exempt from taxation to arrive at the amount you can use to fund this trust.

Grandpa (Or Grandma) knows best: Grandchildren's trusts

If you're not sure whether your children are ready to handle large sums of money, chances are good you're even more convinced that your grandchildren aren't ready. *Grandchildren's trusts* are like children's trusts in almost every respect except one: Transfers made into trusts created for grandchildren are subject to the generation-skipping transfer (GST) tax. (Check out Chapter 17 and the nearby sidebar, "Skipping generations," for more on this tax.) Although this particular tax also has annual exclusion amounts (the same as the gift tax annual exclusions), the amount that you may transfer GST tax free is limited to a cumulative $1 million over your lifetime. Any GST tax you pay is in addition to any gift taxes or estate taxes also owed on the transfer.

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Grantors often create these trusts to provide funds for a specific purpose, such as education or toward the purchase of a first home. But these trusts often also allow the trustee a great deal of discretion when choosing to make a distribution for another purpose. As with children's trusts, they also sometimes create them with an end plan in place so that the principal is distributed to the beneficiary at specific ages.

Skipping generations

Probably the least likely answer to the question "What kind of tax do you think of when someone mentions taxes?" is the generation-skipping transfer (GST) tax. It is, as its name suggests, a tax based on the transfer of assets between generations that bypasses at least one generation along the way. Whenever a grandparent transfers property to a grandchild, for example, if the intervening child (that is, the donor's child and grandchild's parent) is still alive, a generation has just been skipped, and you need to pay attention to this tax. Likewise, if a person makes a gift to an unrelated friend and there's more than a 37½-year age gap between the two, the IRS considers that the transfer has skipped a generation.

The GST tax rules are complex, and you may wonder how anyone could devise such a Byzantine system. The reality is that the concept of GST came about because some wealthy people were trying to avoid paying transfer taxes by transferring their wealth to grandchildren and great-grandchildren rather than their children. Instead of having their wealth pass *step-wise* (from generation to generation) with either a gift or estate tax being collected at every step along the way, these skip transfers had taxes (either gift or estate) collected only every second generation, or in families where Grandma and Grandpa lived into their 90s and beyond, sometimes every third. Like the big one that got away, Congress looked at the lost tax revenue and came up with a system to make sure it assessed tax on every available step on the generational staircase, even if the assets never came to rest on each of them in turn.

GST taxes are calculated and assessed in addition to gift and/or estate taxes on transfers made to *skip persons* (the grandchildren or other recipients in the skip transfers). Unlike the annual gift tax exclusion, you can't exclude a set amount each year from the tax; you are, however, allowed to exclude $1 million over the course of your lifetime and after your death. Small and moderate-size estates can pretty easily avoid the GST tax altogether, even if they make transfers to grandchildren and the like. In larger estates, it becomes a question of getting the most bang for your exclusion bucks. For example, large estates often apply GST tax exemptions to trusts funded with life insurance policies. The grantor applies the GST tax exemption against only the relatively small transfer of cash to pay the insurance premiums. When he or she dies and the face value of the policy is paid into the trust, the new value of the trust far exceeds the amount of GST tax exemption the grantor used to fund it, but all those proceeds are now GST tax exempt.

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Better safe than sorry: Insurance trusts

Many grantors own assets, such as a company they own or the family farm, that can't readily go into a trust. But those items still have real value and are part of the total estate when calculating estate taxes. Of course, if that type of asset represents the bulk of the decedent's estate, the estate may not have enough cash to pay the tax man when the time comes. Enter the insurance trust, a type of irrevocable trust funded during the grantor's lifetime. An *insurance trust* uses insurance policies (plus a small amount of cash) as the only type of asset. The trust owns the insurance policies on the life of the grantor, and the trust is the sole beneficiary. In fact, insurance trusts are a reasonably inexpensive way to make sure that adequate funds are available to pay the cash needs of a decedent's estate that may be otherwise short of cash, without forcing a fire sale of other assets that may not be readily marketable.

When the grantor dies, the policies pay into the trust. Money is then available to pay the debts of the decedent and the estate, including any estate taxes due. But if the trust is structured correctly and the premiums have been paid by using the grantor's annual exclusion from gift tax or some of his or her lifetime annual exclusion, the face value of the life insurance policies on the grantor's death isn't included in the grantor's estate for estate tax purposes.

It's only a name, not a description: Crummey Trusts

In a *Crummey trust,* creating the illusion that the beneficiaries have the right to use the gift at the time it's given (a *present interest*) is the key. Without a present interest, the grantor can't use the annual exclusion to eliminate any gift tax consequences.



Crummey trusts are named for *Crummey v. Commissioner,* a court case decided in the 9th Circuit in 1969. The case enabled a grantor to make a gift into trust of a *present interest* in property that wasn't really a present interest gift, while claiming an annual gift exclusion for it at the same time.



Although a Crummey trust may sound complicated, it's really not. Here's how it works: In a Crummey trust, the grantor transfers money equal to or less than the annual exclusion amount into a trust set up for the benefit of his or her children and/or grandchildren. At the time the gift is made, the trustee sends a letter to all the named beneficiaries informing them of the gift and telling them that they have a right to withdraw some or all of that gift within a specified period of time, usually 30, 45, or 60 days. When the beneficiaries fail to take the money out of the trust during this period (and the grantor, trustee, and beneficiaries all understand that the beneficiaries won't be asking for their money), their ability to do so lapses, and the money now remains inside

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the trust. This ability to withdraw the contributions at the time they're made, even though no one ever exercises their right to do so, creates the present interest required for annual exclusion gifts and is called a *Crummey power*.

In a Crummey trust, the trustee is responsible for investing the cash, allowing it to grow over time. At some date far in the future, distributions may be made to the beneficiaries, many times to pay for education or the purchase of a new home. In some cases, the trust terminates at a specific date or as the beneficiaries reach certain ages, with the principal being paid out to the beneficiaries. In others, the trust may operate long after the contributions have been made to it, paying income and/or principal to the beneficiaries according to their needs.

Many grandparents have paid for their grandchildren's college educations by funding Crummey trusts for them. Although these trusts aren't afforded any income tax breaks (unlike specifically designated college savings accounts such as Section 529 plans or Coverdell Education Savings Accounts), Crummey trusts may be far more flexible than either of those accounts. With a Crummey trust, the principal doesn't have to be used to pay for education, and the distributions are discretionary. So the grandchild who may land a four-year free ride for whatever reason won't have a mountain of unnecessary college savings, and the grandchild who may otherwise qualify for outright grant or scholarship money won't be penalized because of money that has been explicitly set aside for his or her education.

Keeping a finger in the pie: Grantor-retained interest trusts

Sometimes, grantors want to put specific property into trust but aren't sure that they're ready to lose the benefit from that property yet. Welcome to the world of *grantor-retained interest trusts*, where the grantor makes the gift of property into trust but holds back an interest, either in the income from the property or the use of the property (in the case of real estate), for a specified period of time.

Because the grantor hangs onto an interest in the property transferred for a period of time, you may be tempted to view these trusts as grantor trusts, discussed earlier in this chapter, so that no gift tax returns would be required because the grantor didn't give up complete control of the property in question. Grantor-retained interest trusts are more of a hybrid, though — although the grantor does hang onto an interest, that interest is finite, and the transfer of property into one of these trusts does constitute a gift requiring him or her to file Form 709. But the value of the taxable gift isn't the same as the value the property had in the hands of the grantor. Instead, the gift tax value is the value of the property at the date of the gift, less the value of the grantor's retained interest.

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Why bother with grantor-retained interest trusts? In three words: to reduce taxes. You can substantially reduce the gift tax value of property by using one of these trusts, perhaps permitting the transfer of substantial property to subsequent generations without triggering a gift, or later, an estate tax. In addition, transferring property today (as opposed to years down the road) almost always saves on taxes because taxes are based on the property's value at the time of transfer, and values usually (but not always) go up and not down. And although you should never make any estate planning decision purely based on the tax consequences, we've both been involved with plenty of these trusts where large potential transfer tax bills were almost entirely eliminated because the grantor thought to create a grantor-retained interest trust.

Grantor-retained interest trusts come in many varieties. Among the most popular (and people really do refer to them by their acronyms, so don't be shy) are the following:

- **Grantor-retained Income Trusts (GRITs):** The grantor transfers property into this trust but holds onto the income earned by the trust for a period of years. At the end of the period, the property either distributes out to the beneficiaries, or remains in trust, but now the beneficiaries receive the income.
- **Grantor-retained Annuity Trusts (GRATs):** The grantor transfers property into trust and receives a scheduled and fixed payment from it, based on a percentage of the initial value of the transfer, for a period of years.
- **Grantor-retained Unitrusts (GRUTs):** The grantor transfers property into trust, and like with a GRAT, retains the right to receive an annual payment from the trust for a period of years. Instead of a fixed annuity amount determined when the trust is initially funded, the unitrust payment changes annually, and is calculated based on an asset valuation done on a specific day each year. In most cases, that date is the second business day of the calendar year. (Don't ask — we're just responsible for telling you the rules, not for making them.)
- **Qualified Personal Residence Trusts (QPRTs):** The grantor transfers his or her home into the trust, retaining the right to live there, rent free, for a period of years. After the specified period ends, the property now belongs to the named beneficiaries (usually the children but sometimes the grandchildren), and it's up to those beneficiaries whether to allow the grantor to remain in the residence. It's very important, though, that the grantor now pays the new owners market rent for that house if he or she continues to live in the home. Otherwise, the IRS may decide that the grantor never actually made the gift and therefore still owns the house.

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The rules for structuring a grantor-retained interest trust, and for determining the gift tax value of the property transfers into the trust, aren't for the weak of heart. This is tricky tax stuff that brings many experienced estate planners to their knees. What's worse, if it isn't done correctly, the IRS may come along at any time and disallow the gift. Unlike income tax returns, which have a specified statute of limitations beyond which time the IRS may not question the return unless they suspect fraud, gift tax returns remain open items with the IRS until the taxpayer's death. The IRS can still question gifts made 30 years ago and change the valuations of gifts or disallow them entirely. If you're thinking of setting up one of these trusts for yourself, find an expert estate planner with plenty of experience to draft the necessary documents and prepare the gift tax returns. And if you've been named as trustee for one of these trusts, getting a second opinion and having a professional of your choosing review the trust instrument is always money well spent. That way, if the document is fine, and the valuations are dandy, you're only out a relatively small fee, but if you do have a problem, your expert will, hopefully, find it and correct it before the IRS catches on.

Exploring Charitable Trusts

Whether you've been extraordinarily fortunate during your lifetime or you prefer that your assets go to charity rather than to your family (whom you may feel you've already given enough to), establishing and funding charitable trusts are increasingly popular elements of estate plans. The days when only the extremely wealthy created private foundations and other types of charitable trusts have disappeared — now, even people with more modest means are discovering that instead of gifting money directly from your personal account to a particular charity, you can be charitable and reduce your taxable estate at the same time.



Charitable trusts allow you to transfer assets out of your estate, with the goal of using all, or a substantial part of that property, and the income earned from it, to act charitably. What better feeling can you have than seeing your money be used for worthy causes?

Of course, because charitable gifts carry with them tax consequences, and because most people have come to rely on tax consequences when making major decisions, giving to charity is rarely as simple as dropping a few coins in a bucket or mailing a check to a worthy recipient. By funding a charitable trust, you not only enable yourself to give a current gift but also provide the means, from the same assets, to make future gifts. And you aren't only entitled to remove these assets permanently from your estate, reducing your taxable estate, but you also get a healthy income tax deduction, upfront, for the transfer. In many ways, it's a win-win situation.

The next sections discuss the two major types of charitable trusts that grantors may create.

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The rule against perpetuities: Property 101

Every first-year law student must wrestle with the rule against perpetuities, and it won't hurt for you to know about it too because we're talking trusts. Simply put, the law historically didn't like property to be tied up in trust forever, so the rule against perpetuities evolved, stating that an interest in property will be void unless it vests no later than 21 years after the death of a life in being when the interest was created. Translation: In states that follow the traditional rule against perpetuities, a trust must be structured so that it terminates no later than 21 years after the death of a specific living person or persons referenced by name or relationship in the trust document. For example, the document may end the trust "no later than 21 years after the death of the last to die of the now-living descendants of my grandparents and my spouse's grandparents." Note that those descendants needn't be beneficiaries of the trust; referencing them merely gives the trust the possibility of a longer life. All well-crafted trusts in states where this rule still applies have a *fail-safe* provision, which provides that, whatever the other provisions of the trust, it won't violate the rule against perpetuities. Phew! That wasn't too painful, was it?

Nowadays, about half the states follow a uniform law that provides that an interest in a trust must vest within 90 years of when the trust was created or the trust will be reformed by the court to meet this requirement. Some states actually have or are repealing their rule-against-perpetuities laws to take advantage of a tax loophole that was created regarding dynasty trusts. (These states hope to attract more trust business (or at least keep trust business from going elsewhere) by eliminating the rule against perpetuities.

Split-interest charitable trusts

Split-interest charitable trusts are trusts where the grantor retains an interest in the trust property. The grantor may create a trust enabling him or her to receive payments during his or her lifetime, or for a period of years, after which the remaining trust property is given to charity (so-called *charitable remainder trusts).* Or the trust may permit set payments to charity from the income and principal for a period of years (the *charitable lead interest*). After that period expires, the remaining trust principal is distributed to the *remaindermen,* or to the people entitled by the trust instrument to receive whatever's left after the charitable lead interest expires (so-called *charitable lead trusts)*. The four major types of split interest trusts are

- **Charitable Remainder Unitrusts (CRUTs):** The grantor receives payments for life that are fixed annually, based on a percentage of the value of the assets (which are usually valued on the second business day of each year).
- **Charitable Remainder Annuity Trusts (CRATs):** The grantor receives payments for life, based on a percentage of the value of the assets on the date the trust is funded.

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- **Charitable Lead Unitrusts (CLUTs):** Charity receives annual payments, calculated on a percentage of the assets (valued as of the second business day of the year) for a fixed number of years.
- **Charitable Lead Annuity Trusts (CLATs):** Charity receives a fixed annual payment every year. These payments are calculated as a percentage of asset value as of the date the grantor gifts the property into the trust.

All CRUTs, CRATs, CLUTs, and CLATs must file annual income tax returns. What makes this an interesting exercise is that these forms aren't typically fiduciary income tax returns like the ones described in Chapter 18. Instead, **Form 5227, Split-Interest Trust Information Return** is your form of choice. Note that Form 5227 is an information return only; no tax is ever due. If the trust you're administering is a remainder trust, you have to give a Schedule K-1 from the trust return to the income beneficiary, who will then be responsible for including all items of income and deduction shown on the K-1 on their personal Form 1040. We discuss how to complete Schedule K-1 in Chapter 19.



Don't fail to file your tax returns, including any state returns that may be required. Just because you're not paying any tax doesn't mean the IRS doesn't want to see what's happened during the year. Failure to file the Form 5227 carries a hefty filing penalty, calculated on the number of days it's late, and maxing out at a whopping $50,000 per return, and the IRS very rarely abates it. It figures if you're swift enough to figure out the positive estate and income tax consequences of setting up one of these trusts, you're also swift enough to make sure that you file the tax returns on time. Although ignorance on other tax matters may sometimes earn you some IRS sympathy, it doesn't here.

Non-operating charitable foundations

You may have heard of the Ford Foundation, the Rockefeller Foundation, and (more recently) the Gates Foundation. These are *non-operating charitable foundations* (sometimes also referred to as *family foundations*), which are established by some very philanthropic folks in order to further their charitable goals. Although these foundations may be incorporated and be run by the full gamut of corporate officers and directors, they may also be governed by a trust instrument and trustees. For many smaller foundations, the trust route is the way to go because the tax reporting requirements are the same and they don't have any corporate filing obligations.

Supercharging your charitable giving by setting up a foundation

Creating a charitable foundation gives new scope to charitable giving. Now, in exchange for the rather hefty charitable donation you can claim on your income tax return each time you transfer assets into the foundation,

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charitable giving is no longer optional for you. The knowledge that you're required to give at least 5 percent of the average value of the assets in the foundation each and every year turns you, and other members of your family, into much more committed and inventive charitable givers.

There's a cost to be paid, though, in making a large gift into a charitable foundation you've established: establishing the foundation's tax-exempt status and annual tax reporting. In order for you to take charitable deductions for gifts you make to the foundation, you must obtain an IRS determination letter, stating that your foundation is a qualified charity.

Filing for tax-exempt status

To do so, file **Form 1023, Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code.** Expect that your application will be rejected at least once, but know that this is a situation of "if at first you don't succeed, keep trying." The IRS will give you explicit reasons why it has kicked back your application. Fix up those problematic sections and resend it. Obtaining tax exemption is a key element for your foundation; without it, you may as well not have one.

After you've filed your application, you also have to file an annual **Form 990-PF, Return of Private Foundation.** Don't wait until you've received your determination letter before you begin filing annual Form 990-PFs; instead, work on the assumption you'll eventually receive your exemption. Form 990-PF, although not an income tax return, is an excise tax return, and you'll be required to pay either 1 or 2 percent of your net income as excise tax. Unlike most other types of trusts, family foundations are allowed to use a *fiscal year-end* (ending the tax year on the last day of any month, not just December) for tax reporting purposes. If you choose a fiscal year-end for your foundation, Form 990-PF is due four and one-half months after the end of the fiscal year.



Filling out the Form 990-PF can charitably be called a nightmare. Chances are good that you won't be able to even attempt preparing this return on your own, and neither will most accountants, attorneys, or enrolled agents. Not to fear — some professional preparers do prepare these returns, but you may have to do some homework to find one. Don't just accept a preparer's word that he or she can do this work; ask to see some evidence. Form 990-PF is open to public inspection, and you're well within your rights to ask to see one he or she has prepared.

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Owning Subchapter S Share in Trust

In a simple world, the only assets owned by trusts would be publicly traded stocks, bonds, and cash. But this isn't a simple world, and many grantors have less traditional sorts of property that they want to transfer into their trusts. One of these assets is often shares the grantor owns in a small business corporation, commonly known as a Subchapter S corporation.

In exchange for a significant tax break over larger C corporations, Subchapter S corporations are governed by somewhat constraining rules over how many shareholders each corporation may have (no more than 75), and who, exactly, may own shares. Trusts usually may not own shares, except for grantor trusts, where the grantor declares all trust income on his or her Form 1040. However, if a trust instrument contains appropriate language and the IRS is notified in a timely manner, trusts may own S corporation shares. This section explains the options.

Qualified Subchapter S Trusts (QSSTs)

In a Subchapter S corporation, the shareholders (not the corporation) pay the income tax on income the corporation earns. The corporate income tax return (**Form 1120S, U.S. Income Tax Return for an S Corporation**) shows all the income for the year, and then splits it among all the shareholders on Schedule K-1. Each shareholder than declares his or her portion of the income on Form 1040. Because trusts, in general, don't fall under the list of approved shareholders, if a trust wants to become a qualified shareholder, it must be certain to pass all the income out to its income beneficiary. Welcome to the world of *qualified Subchapter S Trusts,* or QSSTs.



In order for a trust to be a qualified QSST, it must meet the following conditions:

- The Subchapter S income must be distributed 100 percent to the trust's income beneficiary because that income must be declared on individual tax returns, not trust tax returns. So in order for a trust to own S shares, it must pay out all its income to its income beneficiary. Or, if the trust is a grantor trust and doesn't have a separate tax return, the grantor declares all items of income on his or her Form 1040.
- The trust may only have one income beneficiary during the lifetime of that beneficiary. The beneficiary must also be a U.S. citizen or resident. If the trust beneficiary is a *nonresident alien* (a citizen of another country who doesn't live in the U.S.) or a corporation, that trust can't be a QSST.

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One trust instrument may create multiple QSSTs. If a trust instrument creates these so-called *separate shares*, each of the shares may qualify as Subchapter S shareholders, provided, of course, that the mandatory income beneficiaries fulfill the other requirements for S shareholders.



If only it were as easy as knowing that the trust and the beneficiary are qualified S shareholders. Unfortunately, you have to let someone else, namely the IRS, know. Seek advice sooner rather than later from a qualified professional (attorney, CPA or Enrolled Agent) to make sure that the QSST election is filed on time (typically 2½ months after the S corporation's year-end). Failure to file these elections jeopardizes not only the trust's election but also the entire S corporation's existence as an S corporation. Remember, an S corporation that has even one disqualified shareholder stands to lose its S designation, leaving it liable for double taxation, first on corporation income and then on the dividends paid to its shareholders.

Electing Small Business Trusts (ESBT)

Although QSSTs must have a mandatory income beneficiary who is a U.S. citizen or resident (see the preceding section), *Electing Small Business Trusts* (ESBT) are allowed to have multiple income beneficiaries, and the trust doesn't have to distribute all income. Instead, in an ESBT, the following apply:

- All beneficiaries must be individuals, estates, or charitable organizations.
- The S stock may not be purchased by the trust.
- The trust may not be a QSST or a tax-exempt trust.
- Each potential income beneficiary counts towards the total allowable number of shareholders any S corporation may have.

In an ESBT, the trustee (not the beneficiary) makes the election, notifying the IRS where the corporation files its tax return of the name, address, and TIN for each trust beneficiary. Usually, you must file ESBT elections within 2½ months of the corporation's year-end.



Like QSSTs, ESBTs are a tricky beast best not attempted on your own, at least while you're getting going. Making a mistake here jeopardizes not only the status of the trust's election but also of the corporation's S election. And if you think messing up a trust tax return is bad, just wait until you have a bunch of angry former S shareholders hunting you down because they now have to pay more taxes due to your error.

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Chapter 4

Assembling Your Team Members and Knowing When to Use Them

In This Chapter

- Identifying what you can and can't do yourself
- Locating an attorney
- Assessing accountants
- Finding other experts and assistants

The universe of trusts and estates is quite unlike any other and has its own sets of rules and conventions that may seem completely foreign. In the fiduciary (trust and estate) universe, accounting rules are different, and so are many of the tax laws.

Navigating these new waters by yourself isn't impossible, but it's also not uncommon to want expert advice and assistance along the way. In this chapter, we tell you about different types of advisors you may want to consult, from attorneys and accountants to investment advisors, appraisers, and other assorted professionals.

Deciding to Go Alone or Ask for Help

We both know lots of people who have successfully maneuvered their way through the world of estate or trust administration unassisted. Many of these were folks whose professional lives touched on this area, so they had some idea of where to start and how to proceed. We also know plenty others whom we met midway through the administration process, after the executor, administrator, or trustee finally threw up his hands in defeat.



You can find a middle ground. Administering a trust or estate without professional help is entirely possible, but you shouldn't assume that you'll be able to do it without doing some homework. The fact that you're reading this book is a great starting point, but we'd be remiss if we didn't point you to some other resources as well. Among these resources are the following:

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- **IRS Publication 559, Survivors, Executors and Administrators:** Although reading this publication may not be your idea of a good time, it's a key resource and highlights important issues you need to be aware of. It not only gives you tax advice for the *decedent's* (deceased person's) final Form 1040, the estate's (or trust's) Form 1041, and the estate's Form 706 (see Chapters 16 and 17), but it also gives general administration advice, comprehensive income tax return examples, and a valuable checklist of forms and due dates.
- **Instructions for tax forms:** We'd love to say that we never read the tax form instructions, but we'd be lying. They seem dense and intimidating, especially if you're not sure where to look. Fortunately, most give instructions line by line, and very often terms and concepts are introduced either at the beginning of the instructions or at the start of a particular chapter within the instructions. If you're afraid of losing the information after you've located it, make a photocopy of the appropriate page, highlight the pertinent text, and keep it together with your copy of the return and any supporting documents.
- **Your local probate court (or its equivalent in your state):** In addition to being the best place to locate all the probate forms you need, most also have pamphlets available that explain the probate process in your locale. Making friends with clerks or assistant registrars at the probate court never hurts. Many of them have been there longer than the furniture, and what they don't know about probate isn't worth knowing.
- **Your state department of taxation or revenue:** Every state has specific requirements for trusts and estates, and many have publications available to help guide you through the process. In addition, if you have questions, call the state tax department and ask to be transferred to the fiduciary (or trust and estate) section. Every state tax department has at least one person in that area. Make sure that you get her contact info and keep it handy. If you run into trouble down the road, having a person who is familiar with your situation is invaluable.



We don't suggest you ever phone the IRS for fiduciary tax advice. The IRS doesn't focus its training on fiduciary tax, and its telephone support is spotty, at best. What's worse, you don't know whether the person on the other end of the phone actually knows what she is talking about. If you can't find the answer you're looking for in writing, you may want to ask the question of a private practice tax expert who specializes in trust and estate returns. She may be willing to answer your question for free if it's a simple one, or at least point you in the right direction. See the section "Hiring a Tax Professional" later in this chapter.

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Finding an Attorney

The prospect of estate or trust administration leaves you cold, or you've already begun delving into the administration and realize that you're in over your head, you may want to consider hiring an attorney to either shepherd the process from beginning to end or to help you with only certain aspects of administration. For example, you may want help with the probate process and with preparation of the estate and income tax returns, but you feel you should be the one to go through the house and figure out what the decedent owned. Even doing this much yourself can save you a pretty penny in fees, and the experts are usually happy to have you do as much fact gathering as possible.



Whatever the extent of the work you want an attorney to perform, finding one you can work with for a reasonable fee isn't an impossibility. Before you start, though, make sure that you have some idea of the scope of work you want the attorney to undertake for you. A common pitfall in estate and trust administration is not having a grasp of who's responsible for what. Although any attorney worth his weight will have a comprehensive things-to-do list that covers most scenarios, the only sure thing about estates and trusts is that no two estates or trusts are alike. When working with an attorney (or any professional, for that matter), make sure that everyone knows what they're supposed to be doing and every job is covered. Nothing should ever fall through the cracks.

This section can help you not only locate an attorney but also choose one after careful investigation. After you hire an attorney, you also need to know how to pay him or her. This section helps you with payment options.

Where to look

When searching for an attorney to help you with your estate or trust, you may be wondering where the best place to find him or her is. Unfortunately, you can't rub a magic lamp and ask for an attorney to appear, but you can do some investigative work on your own to uncover one that's a good match for you. Check out the following resources when searching for an attorney:

- **Phone directory:** Your first thought may be to rush to your phone directory and start flipping through the listings. Chances are good you'll see pages and pages of attorneys listed. You'll probably notice multiple display ads touting this or that firm's expertise with various types of law.

  Although we certainly don't think you should ignore the phone book (or any other form of advertising) when finding an attorney to assist you, we don't think you should rely on this information entirely. No one is checking the validity of the claims being made in advertising, and anyone with a law degree can hang out a shingle stating that she concentrates in this area. Just because someone says they're competent doesn't mean that they are.

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- **Martindale-Hubbell:** This database lists most lawyers in the United States as well as many of those in foreign countries; we're not sure we'd consider using an attorney who wasn't listed in Martindale-Hubbell. You can find attorneys all over the country by using their free Web site, `www.martindale.com`. Not only can you search for attorneys and law firms by practice type (and the practice type you want is either *Trusts and Estates* or *Wills and Probate*) and location, but you can also check out the peer rankings (other attorneys' opinions of this attorney's expertise). (A rating of CV is very good, BV is even better, and AV means the attorney is one of the greats in that area.)
- **Local, county, and state bar associations**: Bar associations all have lawyer referral services, which match you with an attorney in your area whose law practices focus on the area you request. Referrals are free and made on a rotating basis. Your first half-hour appointment with the attorney is typically billed at a much reduced rate, often as little as $25.
- **Personal references:** You may already know someone who's been in charge of someone's estate or trust, but you're just not aware of it. Ask people you trust where you work, within your family, or at your place of worship if they've personally worked with an attorney on estate or trust matters and whether they were satisfied with the service they received.
- **Referrals from other professionals or within law firms:** You may already be working with a tax pro or an investment advisor who may have the name of an attorney whom they know to be competent and reasonable. Or you may be the client of a large firm that practices in many areas, even if the attorney you usually employ doesn't do trust and estate work. Generally, referrals from other professionals are good ones — after all, the professional reputation of the person who makes the referral is as much on the line as that of the person being recommended. Referring a nonqualified person doesn't benefit anyone.



The law is a vast topic, and attorneys specialize. Although your cousin's brilliant child may be a cutting edge corporate or real estate lawyer, she's not going to be particularly helpful to you in probating an estate. Also, because a nonspecialist isn't as experienced in these matters, every task will take longer, increasing the size of your eventual bill. As a result, make sure that you thoroughly investigate the attorneys' credentials to ensure that they're qualified to handle your estate or trust.



In order to double-check an attorney's credentials, check out the following:

- **His law firm's Web site:** Before you actually speak to him, visit the firm's Web site. Often, Web sites include abbreviated resumes, lists of articles written, or professional and charitable organizations the attorney is involved with. Because you may find yourself working closely with this person for a period of months or years, this relationship is an important one. The more info you can gather upfront, the happier you may be with your final selection.

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- **Your state's licensing and oversight agency for attorneys:** Particularly if the attorney you select isn't personally known to you or to someone you trust, you can check with a Board of Bar Overseers or the like to make sure that the attorney hasn't had any complaints or malpractice suits filed against him — or at least none with any merit. (You can consider overlooking nuisance lawsuits, but you would want these explained away very thoroughly.)

Asking the right questions

Finding a competent attorney is only the first step in crafting an effective partnership between you (as the executor, administrator, or trustee) and your new attorney. Now you must establish lines of communication and determine whether you and this attorney are compatible.



Although working with an attorney isn't really like a marriage, two people with completely different work styles and ethics will be sure to rub each other the wrong way. Before you get too involved in the whole administration process, you may want to interview the attorney to get a sense of whether you'll be able to work efficiently with this person. Among the questions you may want to ask are

- How much experience do you have in administering trusts and estates?
- How often do you check in with your clients?
- How long does it typically take you to respond to requests from clients?
- Who actually performs the work — you or a paralegal, trust or estate administrator, or legal secretary? Of course, if a subordinate is actually preparing the work (with the advisor simply reviewing it and being ultimately responsible for it), the arrangement can be very cost effective for you because the hourly rates for junior staff members are always lower than those for more senior attorneys.
- How do you prefer to communicate with clients — via phone, written correspondence, e-mail, or in person?
- What are your privacy policies?



Only after you have answers to these and whatever other questions you may come up with can you be fully prepared to decide whether to hire this attorney or not. If you choose to, great! Your search is over. If you find the little hairs on the back of your neck at attention, though, you may want to continue looking. Remember, you probably kissed a lot of frogs before you met your life partner; this choice, although not the stuff dreams are made of, can turn into a nightmare if the attorney you hire is actually a toad. And remember, if you decide at a later date that the attorney you've chosen is no longer someone you'd want to bring home to meet your family, you can change. An estate or trust attorney works for you, the executor or trustee, and not for the estate or trust. If you're not happy, keep searching until you find the right person.

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Discussing payment options

One of the biggest questions, and one that most attorneys are very happy to discuss, is the manner and size of the payment. Attorneys involved in estates may charge fees in one of three ways (plus they all charge for miscellaneous disbursements, which are almost always additional):



- **Hourly fee:** The most common type of fee arrangement, attorneys bill you for the number of hours (or partial hours) they spend on your estate or trust. They'll tell you upfront how much they charge per hour. Don't be shocked at some of the numbers you'll hear. For example, we recently heard of an attorney in New York who just passed the $1,000 per hour barrier. Although that example is extreme, high hourly rates don't always equate to the best legal help money can buy.

  Large firms charge more because their overhead is greater, and single practitioners who hang out their shingles in the town square charge less. Keep in mind, though, that the overall fees charged by the large firm are often comparable to those of the single practitioner because the large firm has staff such as trust and estate administrators (who are experts in this area but who bill their time at a much lower rate) actually perform the work; the attorney in charge mostly supervises. Attorneys bill hourly fee arrangements periodically, sometimes as often as monthly.

- **Flat fee:** Usually calculated as a percentage of the value of the estate. If the attorney manages to efficiently administer the estate, you know in advance how much the fee is, and the attorney usually walks away very happy. Flat fees are normally paid on a schedule or in partial payments whenever the attorney bills you. This sort of fee arrangement is most common in small- to medium-size estates, rather than larger estates, because not only the probate court but also the IRS must approve the fees an estate attorney charges if an estate tax return is filed.

- **Contingency fee:** Although rare in the world of trusts and estates, in certain circumstances an attorney may accept an estate on a *contingency fee* basis, or a percentage of the amount collected by the estate. If a trust or estate is suing another party in a lawsuit and stands to potentially receive a substantial cash award in the future, a lawyer may agree to represent it (and you, as fiduciary) in exchange for the chance of receiving a hefty piece of that award.

- **Miscellaneous disbursements:** No discussion of attorneys' fees is complete without alerting you to the fact that all the attorney's fee covers is his time. Everything else is extra. Expect an itemized breakdown on every invoice of things like postage, photocopying, delivery services, filing fees, and even the sandwich you ate when you met the attorney for a lunchtime conference.

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Fees aren't typically negotiable. An attorney presents you with her terms before you decide to do business. You can usually ask an attorney who normally charges a flat fee to bill you on an hourly basis, but those who charge hourly or on a contingent basis probably won't change, although you may convince one to give you some sort of discount (perhaps you're friends with her great-aunt?) Even a discounted rate will cost you plenty if the attorney is doing everything. The best, and surest, way to keep fees low is to do as much of the work as you can yourself.

Finalizing your decision

Whether you meet with one attorney or with several, you'll eventually find one that fits your personality and wallet. Remember, your choice isn't irrevocable. You may change attorneys at any time and for any reason. Unhappiness with your choice, even without professional misconduct or shady dealings, is reason to try again.

In order to formalize the arrangement between client and attorney, the attorney may require that you sign an *engagement letter,* outlining the scope of the work to be performed, and each of your responsibilities. For example, you may be responsible for providing the attorney with all relevant information, and she may undertake to provide necessary forms and documents to be filed. Generally, these letters are formulaic, but you should still take the time to read through them carefully. Anything you don't agree with can be crossed out and additions can be manually inserted, provided that both you and the attorney initial the changes. Ask questions if anything in the letter is unclear. After all, it's your decedent's money.

Working with your attorney

Hiring an attorney (or other professional) you like is only the first step. Now you have to work with him or her, and the success or failure of your new relationship rests on how responsive each of you is to the other.



Good communication is the key. When you receive requests for info, you should try to respond within a reasonable length of time. If you're not able to give him or her a complete answer reasonably quickly, you should make a phone call or send an e-mail outlining where you are in the process and how soon you anticipate having a complete answer.

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Choosing where to look for a professional advisor

Strange as it may seem, looking in your hometown for the advisors you need to assist you in administering a trust or estate may not be the best choice. Because the estate must go through probate in the county in which the decedent lived when he or she died, choosing an attorney or Certified Public Accountant licensed in that state is usually best. That attorney or accountant will be up-to-date on all the specific rules for that state and will be able to more efficiently help you through whatever probate and/or tax issues you may have than an attorney or accountant from a different state can. As a matter of fact, if the attorney will be appearing or filing documents in the probate court on your behalf, he or she must be licensed to practice law in that state.

On occasion, the decedent will have owned property in more than one state, and probate must be established in each state where he or she owned real estate. In that case, your attorney may encourage you to hire attorneys in the other jurisdictions. In fact, attorneys who specialize in estate and trust work often have reciprocal arrangements with attorneys in states, such as Florida and Arizona, where many people own second homes. If you're happy with the work your attorney is doing, odds are you'll also be happy with the services of someone he recommends.

The location of your advisor makes no difference when your major concern is investing, although you do want to make certain that the advisor is aware of the estate or trust's state of residence. This knowledge often affects the investments the advisor suggests to you. When probating an estate, be sure any advisor you select is licensed to do business in the estate's state of domicile.

Finally, if your expert of choice is an Enrolled Agent, or someone who is licensed by the U.S. Treasury specifically to deal with tax and tax-related issues, you may comfortably hire one from any state in the country. Enrolled Agents are licensed by the federal government, so they may practice in any of the states, territories, possessions, or commonwealths of the United States.

Hiring a Tax Professional

In the process of administering the estate or trust, you may find that the tax and accounting requirements are beyond what you're happy or comfortable doing. If this describes you, having a tax professional, like a Certified Public Accountant (CPA) or an Enrolled Agent (EA) on your team, can help ensure that the trust or estate is always in compliance with tax and accounting rules.

You're not alone if you're not sure of the difference between a CPA and an EA. CPAs are qualified in all areas of public accounting, including taxation and auditing. EAs, on the other hand, specialize only in taxation. Because public accounting rules don't apply to trusts and estates, both EAs and CPAs, if experienced in this type of work, can competently perform any of the accounting functions required, such as account preparation or figuring out how much, and what, property will roll from the estate to the trust after the estate terminates and trusts assume ownership of the decedent's assets.

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Whether you choose a CPA or an EA, both are subject to rigorous regulation and are required to participate annually in continuing education. Provided the person you choose has experience with trusts and/or estates, either is well qualified to assist you. This section can help you make the right choice.

Where to look

Unlike looking for an attorney where you can search a database, no single place exists for finding CPAs or EAs. If you're searching for a CPA, you can check with the state board of accountancy in the state where you want to hire one, or with that state's CPA professional association. You can locate EAs through their national professional organization, the National Association of Enrolled Agents (NAEA), or through their state or regional organizations.

In addition to assessing state licensing boards and state and federal professional organizations, you may also request referrals from family, friends, and other professionals, such as attorneys or investment advisors, who may keep lists of CPAs and EAs with whom they've dealt with in the past.

It's common practice for CPAs or EAs to have you sign an engagement letter when you hire them, which outlines the scope of the work to be done, who is responsible for obtaining necessary information, and the level of review they will use to determine the accuracy of that info.



Hiring an accounting pro who will provide you with the service you need is really no different from hiring an attorney — you need to know that your work styles complement each other and that you won't drive each other nuts during administration. You should ask any CPA or EA you're considering employing the same questions you ask the attorney (check out the "Asking the right questions" section earlier). Don't hesitate to add any others you may think of.

Discussing payment options

CPAs and EAs typically charge for their services, based on the number of hours worked or the number and type of tax forms prepared. In the case of a trust or estate, most bill on an hourly basis. Costs such as photocopying, postage, and deliveries are often additional, although individual accountants may cover these incidental costs by charging slightly more per hour. Accountants' hourly fees are usually less than attorneys', but they're still in the same ballpark. Be prepared — we don't want you to suffer from sticker shock.



Be sure to establish not only the hourly rate but also what it includes *prior to* having a tax professional prepare any work for you. It's awful, both for you and your accountant, to have an initially positive relationship sour upon receipt of that first bill, purely on the basis of a misunderstanding.

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Accountants, like attorneys, often have subordinates perform many of the tasks you've assigned to them, with Mr. or Ms. Big supervising the project and taking the responsibility for its timely and accurate completion. Remember, the employee who actually performs the work is probably quite expert. As an added bonus, because the person doing most of the project is charging you less per hour, this practice is much more economical for you.

Considering Help from Other Pros

Very often, executors, administrators, and trustees are thrust into situations for which they have no preparation and no experience. You may find yourself in this category as you attempt, for example, to dispose of Auntie Bess's doll collection, rent Uncle Sam's house, or invest Cousin Mercy's millions. Figuring out what you have, what its value is in the estate or trust, and maintaining that value, is often a job for the experts. This section highlights a few other professionals you may need to help you fulfill your duties as head of the estate or trust.

Determining whether you need an investment advisor

Both of us are reasonably savvy investors with decades of experience in various investment strategies; we both can easily tell you the difference between stocks, bonds, and options. Despite our comfort with handling large sums of other peoples' money, we wouldn't hesitate to hire an investment advisor to advise us on investing estate or trust funds.



The unfortunate reality is that, in a world where corporations and individuals alike are sued for seemingly frivolous reasons, an executor or trustee who fails to act prudently to preserve the value of the assets is fair game for a lawsuit. If you're in charge of assets that require investing, you should protect yourself against charges that you acted improperly; hiring an investment advisor provides you with an insurance policy against such accusations.

Doing it yourself (At your own risk)

Perhaps you're leaning toward investing the money yourself. Maybe you assume that no one will else want the bother of managing the small pot of money you have to invest. But how do you even know if you have enough assets to bother with the expense of an investment advisor? If you have $600,000 or less, you may choose to use a full-service broker. He can advise you for the cost of the commission he makes on each stock or bond purchase and sale, or you may opt to invest in mutual funds (which are invested by a professional money manager), bypassing the need for a separate investment

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advisor. For larger amounts, or if you want to invest only in individual securities, you may want to hire a reputable advisor whom you trust. In making this decision, keep in mind that, unlike the trust assets, which may be in there for the long haul, estate assets are held for a relatively short time.

Because your duty as executor is to preserve, not grow, the estate, your investment decisions may be quite simple if your duty is to distribute the estate outright to the beneficiaries upon its termination instead of continuing it in trust. See Chapter 7 for more on making the decision whether to sell assets to protect against your liability.

Going with an investment advisor

If you want to go with a professional to help you invest the money, you have a few options. However, unlike an attorney, CPA, or EA, who must be credentialed either by a state or the federal government in order to practice, an investment advisor doesn't have to have any specific credentials. Among the professionals who offer financial advice are the following:

- **Certified Financial Planners:** Licensed by the Certified Financial Planner Board of Standards, these individuals have completed extensive additional education in addition to their bachelor's degree.
- **Attorneys, CPAs, or EAs:** Their training isn't specifically in investments, but many of them have become quite expert in this area because of the nature of their practice. Don't assume that every attorney or tax professional is qualified to also act as your investment advisor, but don't rule out the possibility, either.
- **Stockbrokers:** Full-service brokers not only purchase and sell securities for you but also research the companies they recommend. Stockbrokers must have passed the Series 7 exam in order to qualify. Remember, an online or discount broker doesn't provide investment advice; he merely places the trades upon your instructions.



Knowing where to turn isn't always easy, because no one-size-fits-all. Be sure to ask questions, starting with those you asked when hiring an attorney or a tax advisor (refer to those two applicable earlier sections). And add this important one: Could anyone else (like the insurance company the advisor works for, for example) benefit from the advisor's recommendations? If you don't like the answers, or think the advisor is promising you the moon in order to win your business, move onto the next name on your list. Like speed-dating, if there's anything that makes you uneasy in the first few minutes of conversation, chances are good that this advisor isn't a good fit for you.



Investment advisors expect to be paid for their expertise, but their fees sometimes seem excessive. When negotiating what you're willing to pay for these services, watch for certain warning signs.

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- **Commissions:** Stockbrokers earn commissions each time they buy or sell stocks on your behalf. When stockbrokers have complete control of an investment account, they may *churn* the account, placing trades frequently with the sole intention of earning more commissions. This practice is strongly frowned on. If you think your broker is *churning* (look for frequent trades, especially in small numbers of shares), you should question the broker and advise his supervisor. Short-term investing in a trust or estate account to capture market fluctuations is a no-no, and you, as fiduciary, shouldn't permit it. When administering an estate, one of us found the broker had been churning her account before the decedent's death, so keep this idea in mind as you review those pre-death brokerage statements, too.
- **Fee for service:** This method is the safest way to pay for advice because you pay only for the time the advisor works on your investments. Of course, sometimes the bill may seem high to you. If you suspect that your advisor is padding the number of hours he is billing you and you're not already receiving an itemized statement (which you may have thought to ask for when you established this relationship), you should ask to see a breakdown of the charges. But if the advice you're receiving is good, you may not want to sour the relationship with this advisor by questioning his charges.
- **Percentage fees:** You're most likely to see these fees from advisors who actively invest for you. You give them control of the investments, based on a written understanding between you as to the type of investing you desire. The advisor charges quarterly fees based on two components — a percentage of the market value of the security portfolio and a percentage of income (interest and dividends) earned by that portfolio. You may negotiate the fees at the time you and the advisor are establishing the contract. If you feel the advisor's percentages are too high based on the portfolio's size and how much work you believe will be involved, you can always ask for a lower percentage. Remember, the advisor wants your business, and his fees aren't set in stone.



No one standard regulatory board oversees all investment advisors (although the SEC regulates many of them), so monitoring of them can be spotty. Because they often have almost unfettered access to the trust or estate's assets, the potential for abuse can be high. Make sure you obtain and check references before you hire an advisor, and don't shirk your responsibility by assuming that the investments are in safe hands. Constantly review the advisor's work, asking questions when something doesn't make sense to you. Remember, someone else placed great trust in you and your judgment when they named you as fiduciary; use that good judgment to figure out when something just doesn't smell right.

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Obtaining appraisers where necessary

In a perfect world, property would only enter trusts and estates as cash, as stocks and bonds, or as precious metals, the value of which is easy to determine and maintain. Unfortunately, trusts and estates rarely inhabit a simple world and often include other assets, like the house, the car, jewelry, rental real estate, early 20th century Japanese art, or a comic-book stash. You, as executor or trustee, need to know what it's all worth. And although you may be able to rely on yard-sale values or online auction sale prices for general household goods, you need to find a reputable appraiser for larger items like jewelry, artwork, and real estate.



When searching for an appraiser, go first to the source. If you're holding Aunt Bertha's diamond ring, and it's still in the jeweler's box with the name stamped on the cover, try to find that jeweler. He may still have the original documentation and will be able to prepare an official estimate of value without too much additional work. Likewise, real estate agents often have certified appraisers in their offices (many both sell and appraise property). If you need to value a rare coin collection, go to the local rare coin dealer. In fact, people who sell specialized property are used to appraising, and it's typically one of the services they offer.

Of course, some property is one-of-a-kind and appraisals for these items can be notoriously difficult to obtain. In the case of artwork by an artist who's still living, the gallery that represents his work should be able to provide you with a written appraisal. Auctioneers from top-echelon auction houses can provide appraisals for artwork from deceased artists as well as for antique furnishings. Occasionally, you'll run across singular pieces of art or furnishings that may require you to inquire of art museum curators.



Appraisals are increasingly coming under IRS scrutiny. If you need to obtain an appraisal, make sure that the person appraising the property is an expert in that field. The appraiser will, as a rule, attach to the appraisal a resume or curriculum vita showing his qualifications. If it's not attached to the official appraisal, ask for it. Should the IRS ever question the valuations you use on a Form 706 (see Chapter 16), appraisals jotted down on a piece of paper may not fly, but one that documents the value of the item in question and the qualifications of the appraiser most likely will.

Consulting with other miscellaneous pros

Every estate and trust requires different levels and sorts of advice. Some additional professionals you may want to consult include

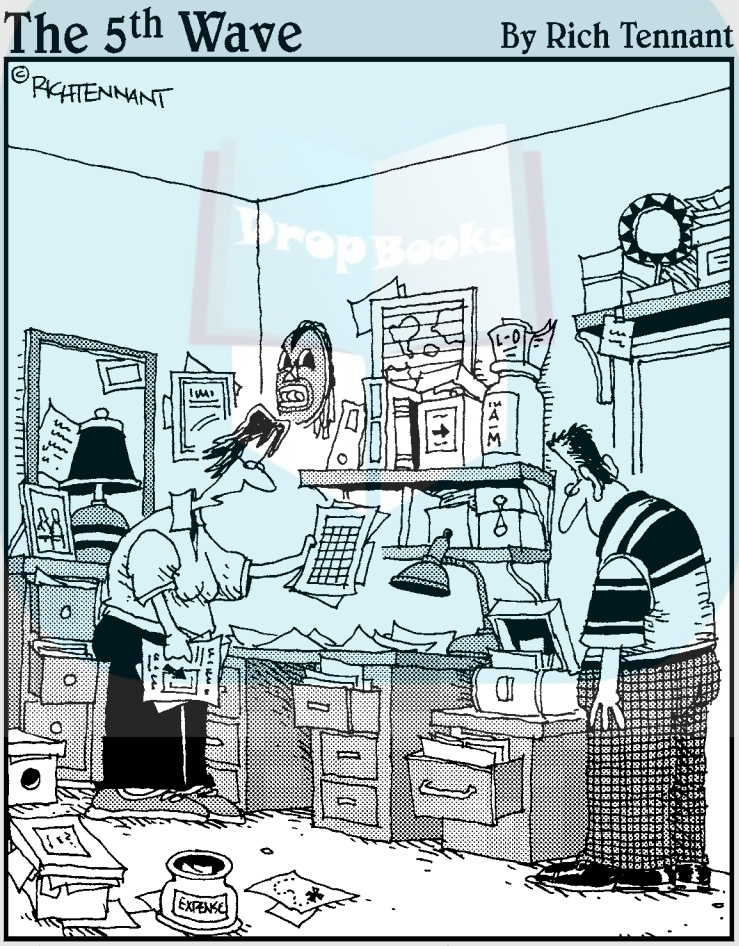
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- **Business consultants:** If an asset of the trust or estate is an operating business, don't be shy about finding someone to help you run it.
- **Charitable advisors:** If you're trustee of a charitable foundation, reputable advisors can assist you in developing the foundation's charitable direction and show you how to identify charitable organizations you may want the foundation to contribute to.
- **Doctors and other medical professionals:** As a trustee, you're often charged with providing resources to guard the health and general well-being of trust beneficiaries. Sometimes, you need to do more than just foot the bill — you actually have to make arrangements with various medical professionals for necessary services.
- **Litigators:** Even though you, as fiduciary, presumably already have an attorney, you may find you need representation in a lawsuit involving the estate or trust. Remember, the trust or estate's attorney isn't always experienced in litigation and in courtroom situations, and will probably refer you to a competent litigator in your area if you find yourself in this situation. He definitely won't be offended if you go elsewhere for representation, and in fact, should applaud the move.

Part II

Administering an Estate

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"I'm trying to organize Dad's documents, and apparently his bookkeeping system was informed heavily by The Da Vinci Code."

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In this part . . .

Whether you know in advance that someone has named you as their executor or you find out at the funeral that you're the one who's been chosen to wrap up the decedent's affairs, facing the task of shepherding an estate from the decedent's death all the way through to its eventual close can seem daunting. It's not typically a small task, but it can be broken into easily digestible parts. Here we take you through each phase of the estate, from figuring out what you have, to paying what's owed, to making distributions to the heirs and devisees, and finally to closing the estate.

Read through this entire part before you do anything, and then begin to make your plan. Remember that not everything happens in sequence; sometimes you need to be working on more than one aspect of the estate simultaneously Your eventual success depends on how well you plan out all the tasks.

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Chapter 5

Taking the First Steps after Death

In This Chapter

- Knowing what you have to take care of right off the bat
- Planning the funeral
- Treating the decedent's assets differently now that he or she has passed
- Figuring out where the estate planning documents are and determining who inherits and how
- Making sure that you notify anyone who needs to know about the death
- Staying organized

The decedent has died and you're now in charge of everything, whether that's because you advised him or her during life, you were friends, or you're the only sibling he or she ever trusted. You may know that you've been appointed as executor, or you may be the only one, in all the confusion of death, who suspects the decedent had a last will and begins the search to find it. Whatever your scenario, you may have many questions, including some you don't yet know you have! Read on for the answers.

This chapter discusses the immediate issues arising after the decedent dies, everything from dealing with the decedent's physical remains to how the situation regarding the decedent's assets changes when he or she dies to what the estate planning documents are and how to locate them, how to identify heirs-at-law and beneficiaries, how to notify everyone who needs to be notified about the decedent's death, and how to stay organized. Although we're not the "estate whisperers," we do help you tame that not-so-bad tiger — estate administration.

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Addressing the Immediate Concerns When Someone Dies

After someone dies, you may be grieving and in shock, which is very understandable. However, some immediate matters need to be addressed. Some may present themselves immediately; they may occur to you naturally, or you may just need to bear them in mind and watch out for them. You need to make sure that the following matters are taken care of. Some of them may not be relevant to your decedent, but others are a necessity.

Honoring anatomical gifts

As soon as someone dies, make sure that you check to see whether the decedent had a notation on his or her driver's license or a donor card, personal identification card, or other legally recognized document by which he or she indicated a desire to make an anatomical gift. Sometimes the decedent will have told loved ones of this decision as well. If the decedent's wishes regarding anatomical donation aren't clear, and the possibility exists of using his or her organs for transplant, the doctors or other hospital staff will explain the available donation options to the family or next of kin. Donation depends upon the family or next of kin's assent; if they agree to the donation made, the organs will be harvested and the body will then be available for a funeral and burial or cremation.

Even if organ or tissue donation isn't made, the decedent may have donated his or her body to a medical school or other institution. The donation may even be contained in a letter of intent located with the estate plan documents. If the decedent donated his or her remains, contact the institution and they'll make arrangements for, and cover all costs of, transportation and eventual cremation. Most will return the cremated remains to the family, if desired.

Having an autopsy performed

Where the decedent's death may have been the result of violence, foul play, or other unnatural causes, or for various reasons detailed in individual state laws, the state medical examiner can perform an autopsy, whether or not the family consents. In this case, the medical examiner's office bears the cost of the autopsy. On the other hand, the family may choose to request an autopsy when it suspects the possibility of medical malpractice (or for other medical reasons). If the family wants to request an autopsy, it should inform the attending physician immediately. In the unlikely event the body has been transported to a funeral home, the family should immediately inform the

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funeral director (who normally won't embalm the body without the consent of the family) so that embalming doesn't occur. The family bears the autopsy cost if it requests the procedure for suspected medical malpractice. If the hospital itself is concerned about a possible medical error, it sometimes requests that the medical examiner's office do an autopsy so that a disinterested third party performs it.

Arranging the Funeral

As executor, you may be asked to arrange the decedent's funeral. Be sure to consult with the decedent's family, both as a possible source for the decedent's wishes and to honor those of close family members. Sometimes, the decedent has left written wishes as to his or her funeral. Look through the decedent's personal papers, especially copies of his or her estate planning documents, to see if he or she left anything in writing with the other documents. Less frequently (but it does happen), a decedent has also written his or her own obituary. As helping hands go, you don't get much better than that — after all, who knew more about what was important in the life just ended than the decedent himself?



Funerals, like weddings, are one of those life events where everyone's nerves are on edge, and feuds ignite out of the slightest of miscues. Tread very carefully as you plan the funeral. Consult, consult, and consult again. Don't rely on the say-so of just one family member; check in with several. Remember, any hard feelings that arise now will carry through the entire course of estate administration. Invest a little extra time to get it right. One of us remembers an aunt who was buried by the wrong (also known as "the other") funeral director in town. Who knows, the funeral may have been beautiful, but all anyone remembers is that it was held in an unfamiliar chapel among — gasp — strangers who didn't know us.

Making important decisions

From the time of the decedent's death, you make sensitive decisions that can mean as much to the family as how you manage the estate.

Choosing a funeral director

Wherever the decedent died, unless they or their family donated organs or their cadaver, their body must go to a funeral home for cremation or preparation for burial. You don't need to figure out how to do this; the funeral director will make all arrangements for transportation of the body and complete all the necessary paperwork.

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The family may have a funeral director they always use, or the decedent's church or temple, if the decedent had a connection to one, may typically use a particular funeral home. If the family or the decedent's clergyperson is unable to guide you, make sure that any funeral director you consider is a member of a state funeral directors association and/or a national association. Check with the local Better Business Bureau to see if a director has any complaints.

Death notice or obituary

You may pay to put a small death notice in the newspaper in major cities. If the decedent was very well known, the newspaper may also publish an *obituary,* which contains more information about the decedent's family and life. Frequently the funeral director will gather information from you or the family and submit it to the appropriate newspaper for write-up and publication You may even have a decedent who writes his or her own obituary in advance, as did one of our relatives. Many families now want a more personalized obituary and submit one already written. You may assist the family in this task, or you may write it yourself. Either way, it's an important testament to the decedent's life.

If your decedent lives in a suburb or smaller town, the local newspaper will no doubt publish a submitted obituary. In many small towns, the obituary section is the first thing readers turn to when they open their newspapers. Newspapers have figured this out, and now encourage the contribution of more information about the decedent than ever before for inclusion in the obituary.

Funeral or memorial service

Funerals occur anywhere from the day after death to a week or more afterwards, depending on religious and local custom, and whether family must travel to attend. Some families hold a wake, also known as calling hours, at the funeral home during set hours (usually on the day before the funeral) or a *shiva* (usually for three or seven days after the funeral). A memorial service is held at a later time, sometimes so that family can plan to travel to it.

If close family is available, they most likely want to be very involved in planning all funeral and memorial observances. More and more commonly, family members want to prepare photo boards or albums of the decedent and the family and to display mementos like framed wedding photos and photos of family groups or other significant events. You want to be sure that flowers are ordered, if appropriate for the decedent's funeral tradition, and ask the family to choose a charity to which memorial contributions can be made, or if the family prefers, to let donors choose their own charities.

You may need pallbearers, in which case the family may want to choose who has this honor. Usually, six sturdy men are necessary, but other older or frailer folks can be honorary pallbearers. Although the tradition is that men be the pallbearers, nothing but tradition says that a woman can't be one. And of course, if the decedent left specific wishes, such as the desire to be buried in a blue velour tux (and it's your grandmother, not grandfather), those wishes should be honored to the extent they're legal.

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On the day of the funeral or memorial service, arrange for someone to watch the house — burglars read the obituaries and death notices.

Assigning eulogies

If a clergyperson is presiding at the funeral, he or she will, of course, talk about the decedent. But in some cases the officiant didn't actually know the decedent personally and has gathered information and memories from family members or close friends. A personal eulogy given by a family member or close friend can be a meaningful addition to the service. You can ask the family who may be appropriate or want to perform this honor. The family may also opt to allow a time in some services when any who want to are offered the opportunity to speak.



Consider vetting written eulogies before the words are spoken. In our experience, funerals can be opportunities to make enemies (often unintentionally). Although we don't advocate censorship in the ordinary course, funerals are a time to bring families and friends together, and to remember the deceased fondly (and maybe even with some humor). It's not the appropriate forum to air dirty laundry or attempt to redress past injustices.

Finding an appropriate clergyperson

The decedent may have had a close relationship with a clergyperson or may have rarely crossed the threshold of a place of worship. If the decedent didn't even have a place of worship, the question may even arise as to what, if any, kind of service the decedent would have wanted to have. Any information left by the decedent is helpful here, but the immediate family's wishes usually trump. The funeral home is always an appropriate setting for the funeral service, and in some religious denominations, it's the traditional setting.

Cremation versus interment

As cemeteries fill up and traditional burials become increasingly expensive, cremation is rapidly overtaking burial as the most popular way to deal with remains. If the decedent wanted to be cremated (with or without burial), he or she will typically have made his or her wishes known to his or her spouse or other family members or friends. The decedent's spouse or other family members may also make the decision to use cremation. If no one close to the decedent is available, or wants to make this choice, it becomes yours; either is okay. Remember, even cremated remains may be buried in a cemetery, either in an actual plot or a *columbarium*, a wall with drawers for the ashes.

Choosing a cemetery

Several options are available when choosing a final resting place for the decedent's remains:

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- If the decedent has prepurchased a plot (frequently several plots together, for themselves and additional family members), your problem is solved: You use the prepurchased plot.
- If no family plot exists, most active cemeteries still have lots available for sale, either through the cemetery, or the resale by private parties of unused lots previously purchased. Choose a cemetery in a place significant to the decedent or one that you and other family members may easily visit, if you so choose.
- When the decedent has been cremated, family members frequently choose to scatter the remains in a meaningful location. In California, many services provide everything needed for a burial at sea, from the paperwork to the boat to biodegradable urns. One of us has a cousin who chose to scatter her mother's ashes in the rapids of a river near our childhood home. And another family we know of divided their father's remains among the children, with each to choose their own special location for their share of the remains.

Headstone or grave marker

Although you don't need to order the grave marker immediately, it's an important task to take care of. If your decedent has a predeceased spouse, the plot may already have a grave marker with room for the decedent's memorial information, in which case you can simply have the appropriate information about the decedent added.

Special burial rights for veterans

If the decedent was an honorably discharged veteran, several benefits are available through the U.S. Department of Veterans Affairs (VA). The following list gives a few of these benefits; check out the VA's Web site (`www.cem.va.gov/cem/`) for more info.

- **United States flag:** Veterans are entitled to a U.S. flag to place folded in the open casket, drape the casket, or accompany the urn. The funeral home typically arranges for this, or you can go to the VA's Web site to obtain the flag yourself.
- **Burial in a national cemetery:** Veterans, their spouses, and their dependents may be buried at any of the national cemeteries with available space (currently 125 with more in the works) for no charge, including grave opening and closing and perpetual care.
- **Headstone or marker:** Whether buried in a national cemetery or not, eligible veterans are entitled to a government headstone or marker, provided by the VA, for their unmarked grave. For eligible veterans who died after November 1, 1990, the headstone is available even if the site already has a private headstone, and as of spring 2009, those whose grave is already marked have the choice of applying for either a traditional headstone or marker or a new device which can be affixed to the private headstone.

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- **Presidential Memorial Certificate:** The Presidential Memorial Certificate is an engraved paper certificate, signed by the current president, that's intended to honor the memory of honorably discharged deceased veterans. Loved ones and next of kin may apply for the certificate, and more than one may be issued. You can download the application on the VA's Web site.
- **Burial allowance:** Deceased veterans may be entitled to a burial allowance. For further information, call 800-827-1000.

Providing a collation

In many American cultures, a *collation*, or light meal, is traditional after the funeral service. It can be held anywhere from the decedent's home, with neighbors and church members (or a catering service) supplying the food, to a church hall or restaurant. When ordering food, be aware of local and religious custom. For example, one of us has the custom of greeting the mourners as they return from the cemetery (the spouse, children, and siblings of the deceased) with hard-boiled eggs, which symbolize the continuity of life. As always, if you're not sure what to do, ask. Family members, a clergyperson, or even the funeral director may be able to give you guidance.

Paying for funeral costs

The estate may pay for all reasonable funeral costs, to the extent that funds are available. The key word is "reasonable." A judge may disallow payment of funeral expenses found to be unreasonable. In many states, funeral expenses, expenses of last illness, and administration expenses take precedence over all other claims against the estate. But if your decedent's estate may be short of funds, keep all funeral expenses to a modest amount. Of course, funds in a decedent's funded revocable trust can be used to pay expenses, if necessary. If the decedent had a checking account joint with his or her surviving spouse, payment can come from that account, with the amount to be repaid from other funds if the spouse doesn't ultimately receive the entire estate, minus expenses. Sometimes the funeral home will wait for payment until the executor or administrator is appointed, but it frequently adds interest to the bill after a set amount of time. You may even apply for temporary executorship to pay for the funeral.

Funeral trusts, where the decedent prepaid for his or her funeral, have become much more common as people are increasingly loathe to land a large funeral bill on the heads of their families. Be sure to check with the named funeral home if such a trust exists. If you suspect the decedent had a trust, but you're not sure with which funeral home, make all the calls before the funeral; it would be a shame to have to pay for a funeral at one home when another home already received payment.

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Don't let the funeral director talk you into something that just doesn't seem right to you. Although his or her ideas may be great, they may also be an attempt to sell you additional services that you don't want or need. Making these decisions just hours after the decedent's death is difficult, and after they've had a chance to reflect on a funeral just passed, some people would have done something different. Remember, the funeral director isn't only helping you at a very stressful point but is also running a business and always keeping an eye on the financial bottom line.

Obtaining copies of the death certificate

You can't even begin to tackle the tasks in front of you without proof that the decedent actually died. Be sure to get a number of certified copies of the death certificate to give to anyone that may need to know about this particular death. For example, you need copies for the probate court (if probate is necessary), for taxing authorities, for each life insurance company, and to collect other death benefits (just to name a few). You pay a small cost for each copy, but the convenience of having them on hand far outweighs that cost. Usually the funeral director obtains them for you. Otherwise, you can get them through the appropriate office in your state, which may be the county clerk's office or the state department of vital statistics.



Although death certificates are a matter of public record, they're also a minefield of information for identity thieves, who treat this information like a kid in a candy shop. You can't prevent identity thieves from obtaining this information directly from state authorities, but you don't need to make their lives easier by handing it to them. Make sure that someone asking you for a death certificate has a valid reason for needing one before you hand it over.

Understanding How Death Changes Everything about the Decedent's Assets

When someone dies, assets owned only by him or her in individual name are essentially frozen. *Frozen assets* are simply inaccessible (that is, neither you as future executor nor anyone else has access to them or can sell, transfer, or take any other action with regard to them); you don't have to worry about them getting freezer burn like your favorite ice cream. Until you manage to unfreeze those assets by being appointed as executor, you can't use them. A few types of jointly owned property do pass immediately to the surviving owner upon the other owner's death:

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- Anything held in *joint names with right of survivorship* (assets which automatically pass to the survivor or survivors on the first person's death)
- Anything owned as *tenants by the entireties* (a form of joint ownership of real estate with rights of survivorship that's only available to husband and wife)
- Assets (typically bank accounts) designated *POD* (payable on death)

This section explains the impact death has on a decedent's assets. They aren't available until you're appointed as executor, and that handy power of attorney that was so useful during the decedent's life is now useless. For now, and until you're appointed as the estate's executor, you can't manage the decedent's assets and no funds are available.

Bank accounts and the need for funds

All assets in the decedent's name alone have to go through the probate process, either according to his or her will or the laws of *intestacy* (a fancy way of saying he or she left no will); bank accounts owned by the decedent alone are no different. Money in these accounts isn't available to the family or the executor until the executor has been appointed. Only then can bank accounts be transferred into an account in the estate's name.



You may open traditional bank checking and/or savings accounts for an estate, or you may opt to use fiduciary services available from commercial banks, investment houses, or in some states, law firm trust departments. As we discussed earlier in the chapter (regarding paying for funeral arrangements), you can request appointment as temporary executor or special administrator if the estate has an urgent need for funds. Chapter 7 discusses how to track down the decedent's bank accounts.

Powers of attorney



Powers of attorney (documents appointing others to act on the grantor's behalf regarding any or all of his or her assets or financial matters) may only be used while the grantor of the power is alive; when the decedent dies, so does the power of attorney. Because the grantor's death cancels the power, don't try to act under its authority after his or her death. Any separate powers of attorney that the decedent may have executed regarding bank accounts also lose their effectiveness with the decedent's death.

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Locating the Estate Planning Documents

When a person dies, one of your many important tasks is to locate the estate planning documents. Frequently, the decedent has photocopies of them in a file at home or in his or her safe-deposit box. If the surviving spouse hasn't personally handed them to you, see whether you can find a home file and search the decedent's papers accordingly. You can also check with the decedent's attorney or other advisors because they may well have the originals of the will and other estate plan documents in their will vault; at the very least, they hopefully have copies, even if the originals are elsewhere. This section highlights the important documents you need to find.

The last will and testament (The will)

The most important document to locate is the decedent's last will and testament. The decedent may have placed his or her will on file with the probate court for safekeeping. This practice isn't the same as filing the will for probate. If you find more than one will, the most recent will governs.

The decedent may also have made changes to his or her will, called *codicils*, which don't revoke the will but expressly add to, change, or remove something from the will. A person can add an unlimited number of codicils to a will. However, because interpreting the many codicils is cumbersome, an entirely new will is usually written after a few codicils have been added. The original of a codicil is always kept with the original will (at least in theory).

Trust agreements and amendments

You also want to locate any trust agreements and amendments to them that the decedent may have had. Although only one copy of a will is signed, you usually have at least two signed copies of a trust because an original copy may be needed in the transfer of assets to the trust and for other administrative purposes. At least one signed copy of the trust should be located with the original will, as should any amendments to the trust.

Even if the trust began its life as a *revocable living trust*, a trust designed to receive assets from the *grantor* (the trust's creator) during his or her lifetime, it becomes *irrevocable* (unable to be changed) at the grantor's death. Depending on what the will's terms are, this trust may not only continue with assets placed in it during the grantor's lifetime, but it may also stand ready to accept assets from the decedent's estate.

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Opening the safe-deposit box and locating the original will

If the safe-deposit box is in the decedent's name alone, normally no one can access it until the decedent's will has been admitted to probate. This can pose a problem if you can't locate the *original will* (although some legal documents are executed in multiples, only one will is ever signed at a time), and you think the safe-deposit box may contain the will. (Note that, in certain circumstances, if the original will can't be found, a copy can be admitted to probate.)

Some safe-deposit box contracts provide that, upon proof of the vault holder's death (such as a death certificate), a search of the box can be made for the will by an officer of the bank at the request of an appropriate party (such as the surviving spouse or next of kin). If the safe-deposit box is held by the decedent as a joint tenant, the surviving joint tenant(s) may access the box, but the surviving spouse or another representative of the estate may request to be present. As a matter of fact, the surviving joint tenant(s) would be wise to have a witness present when they open the box, to witness (in writing) what's contained in the box.

If the bank doesn't allow entrance to the safe-deposit box for a will search, some states allow you to file a petition for appointment of a special administrator of the estate with the probate court so that the special administrator can open the box.

Most states no longer seal the safe-deposit box upon death, as was once common, but some states do still require the presence of a representative of the state taxing authority be present when the box is opened to make sure that no taxable assets disappear before they're counted. Check with your state taxing authority to see whether it requires this practice.

Just as wills may be amended by codicil, trust instruments may also be changed during the grantor's lifetime by amending the trust. An amendment must be agreed to by the trustee(s), because they signed on to administer the trust under its original terms only. But if the trustees don't want to agree to the amendment, the creator of the trust can simply change the trustees.

Letters of intent

Sometimes you find a letter of intent written before the decedent's death on a subject he or she didn't want to put in his or her will (which becomes a public document when it's filed for probate) or trust. The letter of intent can be about something such as who is to get which personal and household articles (although hopefully any instructions regarding an item of great value, such as a piece of jewelry or work of art, are specifically spelled out in the will, to avoid controversy among the heirs). Letters of intent can be valuable tools in helping you carry out the decedent's wishes, because they're often filled with the decedent's own words rather than language that has been legally filtered.

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Other documents that dispose of property

Don't forget to look for life insurance policies with beneficiary designations attached, copies of beneficiary designations as to the decedents retirement plans and individual retirement accounts, and any other assets with death benefits, all of which may be located neatly with the estate plan documents, or scattered throughout the decedent's files, or in some cases, throughout the house. Chapter 7 gives details on how best to locate all the decedent's assets.

Notifying Those Who Need to be Notified

As executor, you may feel that your job is primarily to write letters, because you need to notify seemingly everyone and their uncle of the decedent's death. Some entities and individuals may be more important than others, but you should notify them all as soon as possible.



You can save yourself some time by creating your own version of a form letter that can be modified easily for each recipient. Keep it on your computer's desktop and revise it as needed. You can keep saved electronic copies of each letter sent in a folder on your desktop so you can easily identify who you've sent letters to. The bottom line: Make sure that you organize all this correspondence. (Check out "Setting up a filing system" later in this chapter for more info.)



Make sure that you contact the following entities and individuals to inform them of the decedent's death:

- **The decedent's attorney, accountant, and so on:** At your earliest convenience, contact the decedent's attorney, accountant, investment advisor, insurance agent, and any other professional you're aware of Each may have valuable information that can save you hours of searching for the decedent's estate plan documents, copies of tax returns, asset information, and personal information. The surviving spouse and other family members will likely be able to give you the names of these professionals. You also may meet them at the funeral or memorial service. And you may find their names in the decedent's personal papers, so don't forget to check the papers scattered across the decedent's desk.
- **Heirs-at-law and beneficiaries:** You want to identify the *heirs-at-law* (persons who inherit if the decedent didn't have a will) and the *beneficiaries* (persons who inherit under the will) as soon as possible. If no will exists, you're required to notify the heirs-at-law of your petition for probate; if a will does exist, notify both the heirs-at-law and the beneficiaries. Be sure to get the beneficiaries' addresses, telephone numbers, and Social Security Numbers, and the heirs-at-law's addresses.

  The surviving spouse and/or other family members can provide family information to help you determine the heirs-at-law. After you find

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the last will, you can determine from it who the beneficiaries are. See Appendix B for a state-by-state listing of the laws of *intestacy* (dying without a will) to help you identify the heirs-at-law.

- **Social Security Administration:** Call the Social Security Administration (SSA) at 800-772-1213 or contact the local SSA office (the local office can sometimes be easier to deal with than the phone system) to report the decedent's death. If the decedent was receiving his or her benefits by direct deposit, notify the bank of the decedent's death and request that it return any funds it receives for the month of death and beyond to the SSA.



  Don't close the bank account that's receiving direct deposits before any Social Security checks have arrived and been returned to the SSA, or the checks may be in limbo! If the decedent was receiving his or her benefits by check, don't cash any check for the month of the decedent's death or later; return them to the SSA. The estate isn't entitled to the payments made in the month of death because Social Security payments are actually made for the month ahead, and you don't get partial payments for partial months. So, if the decedent died midway through the month, that month's payment must be returned.

- **Veterans' Administration:** If the decedent was receiving veterans' benefits, call 800-827-1000 to report his or her death. You should also inquire about burial entitlements and other benefits that may be available to a surviving spouse or minor children. See "Special burial rights for veterans" earlier in this chapter, as well as Chapter 7, for a discussion.
- **Pension and other retirement plans:** Notify each of the retirement plans in which the decedent had an interest, whether the plan was sponsored by an employer or created by the decedent. See Chapter 7 for info on the different retirement plans the decedent may have.
- **Employer and employees:** If they aren't already aware of the decedent's death, notify the decedent's employer and/or employees as applicable.
- **United State Postal Service:** If no surviving spouse is still living at the decedent's residence, file a change of address form with the post office, indicating where the decedent's mail should be sent and signing it as executor. If the decedent's spouse survives, you needn't notify the post office, but ask the spouse to send along pertinent mail to you, such as bills in the decedent's name alone. The spouse may also choose to pay them and seek reimbursement from the estate, but should save copies of those paid bills for you.
- **The decedent's landlord, if any:** Notify the landlord of the decedent's death , and if the surviving spouse doesn't want to continue the lease (or there is no surviving spouse), vacate the premises as soon as is convenient, after allowing time for proper disposition of the decedent's personal and household articles as discussed in Chapter 7. In some cases, you may find that you need to keep that home for a while until you can make appropriate distribution. Be sure to review the lease; some leases may have a provision for termination upon death. In many cases, you can reach an agreement with the landlord for early termination.

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- **Creditors of the decedent, including credit card companies:** Notifying them of the decedent's death and the new address for statements makes them aware that you're planning to pay the bills when allowed by the court (see Chapter 8). If any debts are in both spouses' names and the surviving spouse has the funds to make the payments, he or she should make them so that his or her credit rating isn't affected. You can pay the spouse back later from estate funds if it's a debt of the decedent. Make sure any surviving spouse has credit cards in his or her own name.
- **Utilities:** Have them transferred to the surviving spouse's name, if applicable; if the decedent has no surviving spouse, have the utility bills mailed to you until you've cleared out the decedent's residence, at which time arrange for the utilities to be shut off.
- **Membership organizations of which the decedent was a member:** If the surviving spouse wants to continue a membership, arrange it.

Creating Calendars and Files

Administering an estate is a drawn-out process, one filled with a great deal of minutiae. Keeping organized and thorough records of all estate activity, from the decedent's date of death onward, will prevent the terror of wondering whether you've missed one of those (we hate to say it) drop-dead deadlines. It also can save you hours of time as you prepare the estate inventory (see Chapter 7), estate accountings (see Chapter 10), income tax returns (see Chapter 18), federal estate tax return (see Chapters 16 and 17) and any state estate or inheritance tax returns (see Appendix B for applicable state laws). It also makes it easy to answer questions posed by probate court judges, estate beneficiaries, and tax auditors, to name a few. This section highlights the two types of calendars you need, as well as how to keep everything in order.

Eyeing what kind of calendar to create

The best way to stay organized is to create a calendar with all your estate's important dates. Whether you choose to create the calendar on your computer or on paper, make sure to insert all of your estate deadlines as soon as you become aware of them, and refer to your calendar daily to keep your administration on track.



When putting your calendar together, you can devise a system to remind you of deadlines or what task you need to attend to next, even if your system consists of reviewing your calendar on a daily basis. You may refer to Chapters 6–9 in creating your calendar, but, of course, your specific deadlines depend on your estate, whether it's going through probate, and the decedent's state of residence.

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- **For probate/non-probate administration:** Lists all the tasks to be done with regard to both the probate and the non-probate estate in chronological order, based on your situation and the assets of your decedent. You don't want to miss an important date; for instance, if you miss your deadline to prove to the probate court that you've notified all the beneficiaries, you may have to redo the entire notice procedure to each beneficiary, greatly increasing your time spent and delaying your appointment as executor. Refer to your calendar daily; make additions as you find out about new requirements, and bathe in the glow of your accomplishments as you meet each deadline in a timely manner.
- **Calendar for tax deadlines:** Keeping track of the many tax deadlines is very important when you're an executor of an estate. Missing a tax deadline can mean that the estate is charged penalties and interest on any tax due. And because filing tax returns and making payments on time is your duty as executor, the probate court can hold you liable (and beneficiaries can sue you) if your oversight leads to a missed deadline.



You may want to create separate calendars for each type of tax: federal estate tax, state estate or inheritance tax, estate income tax, and final year(s) income tax return of the decedent. Or you can integrate all of your types of taxes into one calendar. See Chapters 16–18 regarding taxes.

Setting up a filing system

An organized filing system for your estate and trust means the difference between order and chaos in your administration of the estate. You may choose to organize as much as you can electronically, but you still have to deal with plenty of paperwork in administering an estate. If you don't have a file that locks, get one and keep the estate paperwork (which is, after all, confidential) safely locked away when you're not working with it.

You can create a file (legal length files sold at an office supply store are best) for the estate with separate file folders within the file for each topic. Some topics may require more file space than others. As a folder grows, you may find you want an entirely separate file for it. Folders within the estate file may start out with titles such as "Correspondence and memos," which may contain all general correspondence and notes, in reverse date order, with the newest on top. You can pin all papers in the folder to keep things in order.



Always make a note of every phone call you make or receive and meeting you have relating to the estate and file it in the appropriate folder. Be sure to date the record and note the name of the person(s) you spoke with. You don't need to craft a lovely memo. Just be sure to note every point that's covered. This practice will prove invaluable when you're following up on any estate matter.

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File folders for the estate administration file may include

- Correspondence and memos.
- Federal estate tax return (Form 706). This one can easily become an entirely separate file.
- State inheritance (or estate) tax.
- Probate pleadings (just a fancy way of labeling all the probate court paperwork).
- Life insurance.
- Retirement benefits.
- Decedent's income tax returns.
- Estate income tax returns.
- Debts of the decedent and claims against the estate.

  However you choose to organize your records, keep a separate record of the decedent's debts, your evidence of the debt, and an ongoing record of your payment of debts.
- Estate assets.
- Any other topics that arise in your estate.



We're firm believers in to-do lists. They help keep you focused on both what you have to do today, including the best order in which to accomplish it, and what you need to accomplish long term. You may want to have multiple lists, one for daily, one for weekly, and one for monthly tasks. Create them on the computer or by hand, whatever works for you, and just wait for that feel-good moment when you cross another item off the list.

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Chapter 6

Navigating the Probate Process

In This Chapter

- Submitting the will to the court
- Deciding whether and what kind of probate is necessary
- Having the executor or administrator appointed
- Considering the surviving spouse's necessary decisions

The decedent has been laid to rest and you've handled the immediate tasks after the death. (Refer to Chapter 5 for what you need to do after the decedent has died.) Now that you've had a moment to breath, you need to take the next steps in wrapping up the decedent's affairs. Now's the time (probably within a week after the decedent's funeral) to decide whether you need probate court administration of any of the decedent's assets, and if so, how to keep probate as simple as possible. *Probate* is the process whereby the decedent's will, if any, is proved valid or invalid and the assets in the decedent's name alone, or payable to the estate, are administered in the probate estate with probate court supervision.

This chapter explains how to get the decedent's will (if any) recognized by the probate court, and how to get yourself appointed as executor(s) (the decedent may name more than one executor to act together). And we point out what happens if for whatever reason you're the person charged with administering the decedent's estate even though he or she didn't leave a will. We also discuss how to create the probate inventory. And if the decedent has a surviving spouse, that person may have some decisions to make. Last, we discuss how a beneficiary or heir can disclaim property.



Throughout this chapter we make reference to state law and probate court rules. No two states' laws are exactly the same, no two states' probate court rules are the same, and as a matter of fact, probate court practices can differ from county to county. And not all courts that administer wills are called "probate courts." So when we discuss the procedure for probating your decedent's property, you can pretty much count on some quirk in how your decedent's county and state handle probate administration that's different from the quirkiness we describe here. We also refer, in general, to the executor. But if there's no valid will, you're the administrator. In some states you're called

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the *personal representative* or some other name, but we're still referring to the person appointed to administer the estate. And the term *fiduciary* refers to all of the above. That's the beauty of individual state law!

Filing the Last Will with the Probate (Or Equivalent) Court

In most states, the person who has possession of the will is required to deliver the will to the executor or file the will with the probate court within a certain period of time (for instance, 30 days) after the decedent's death. If you're in the delicate position of knowing who has the will but hasn't filed it, you may notify the court so that the court can compel the filing. Then the probate process can begin. In practice, you file the will with the petition for probate if you decide probate is required, hopefully within that 30-day window. Most courts give you some leeway, but make sure that you know if your probate court will. If it turns out there are no assets requiring probate, simply take the will to the probate court and sign a statement to that effect.



If the decedent left a will but the estate doesn't have any assets subject to probate, the law still requires you to file the will. Just inform the probate court that, to your knowledge, no assets are subject to probate. This situation can arise when

- The decedent has fully funded (that is, transferred all of his or her assets into) his or her revocable trust before death.
- The decedent held all of his or her assets jointly with rights of survivorship with the surviving spouse or other persons.
- The decedent may have died penniless (which makes your job much easier).

Figuring Out Whether Administration Is Necessary

Before you can decide whether probate court administration is necessary, you first need to get an accurate picture of all the assets in the estate. Chapter 7 explains how to uncover every asset you possibly can. You need a good idea of both the size of the assets and how the title is held. Remember, anything held in the decedent's name alone, payable to the decedent's estate, or held jointly for convenience only (but where the decedent actually acquired the property by himself or herself) is subject to probate.

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To help you make an accurate determination, this section takes you through the steps involved in determining whether and what kind of probate administration is necessary.



Probating the decedent's estate through the probate court system and taxing the decedent's estate for federal estate tax and state estate or inheritance tax purposes are two entirely different animals. Just because you're not dealing with a probate estate doesn't mean it won't owe estate or inheritance tax. Tax law isn't based on how the property was held but rather on who actually owned the property at death, and in the case of state inheritance tax, who receives it. See Chapter 16 to determine whether your decedent's estate is subject to estate tax.

Do you need a temporary executor?

As soon as you receive word of the decedent's death, take a look at the estate plan documents and start compiling the asset information. If any assets subject to probate need immediate action (either to preserve them or their value or to manage them), you may need to apply for *temporary executorship* (can be done only if the will permits) or temporary administrator with will annexed (can be done at the discretion of the court) because your appointment as executor may take a few weeks — or sometimes more — to accomplish. Your appointment as temporary executor or temporary administrator can be accomplished much more quickly than your appointment as executor.

You typically accomplish temporary administration through a written motion to the court where you set out the reasons it's being sought and the powers you're requesting. Some courts may have a form of petition to present. In either case you need to present it in person to the court, along with a certified copy of the death certificate, the original will if it hasn't already been filed, and any other documents required by the local court (check with an assistant probate register). If your request is granted, your powers will be limited to those sought in the motion and approved by the court, except as set out by state law (typically to collect the personal property of the decedent and preserve it for the executor). Some instances in which you may want to apply for temporary administration:

- **To preserve the value of stocks and bonds held by your decedent.** Because of the nature of the stock market, you may want to sell these assets quickly to avoid a decrease in value. (See Chapter 18 for how to calculate any capital gain or loss, which should be minimal.)

  Your duty as executor is to preserve the estate assets for the beneficiaries, not to grow the estate. So, for example, you may want to sell all the volatile securities and convert the holdings into more stable assets to preserve the value of the estate for ultimate distribution to the beneficiaries. Remember, any income tax consequences for the sale of these assets are small because the tax basis has stepped up to the value on the decedent's date of death. And keep in mind that you don't get credit

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or thanks for any gains on assets during estate administration, but you can surely be held accountable for any losses! Check your local law on this issue with an attorney experienced in local probate.

- **To continue your decedent's business.**
- **To manage real property held by your decedent.**
- **To pay expenses of last illness, funeral expenses, and taxes.**
- **To gain access to the decedent's safe deposit box to look for the decedent's will, if your state doesn't provide an alternative means of entering the box.**
- **To bury the decedent.**

One of us had the experience of going to court to seek temporary administration in order to sell stocks and bonds to preserve the estate assets, and the judge she appeared before couldn't imagine why she'd want to sell all the securities. He agreed to the temporary administration for this purpose only after his assistant found the section of the probate law regarding the duty of the executor to preserve assets and showed it to the judge. Don't be too hard on the judge here. In many instances, you're dealing with the probate and family court (with the emphasis on family). In that case the courts see an overwhelming amount of family law (divorce, guardianship) compared to their experience with probate, and many of the judges are former family law attorneys. Many more-experienced judges are expert in probate law.

You may need to file an *executor's bond* (a written promise to faithfully carry out your duties as executor), and even the temporary administrator must file an inventory and an account. The temporary appointment ends when the executor under the will or administrator (no will) is appointed.

Do you need a special administrator?

A special administrator can be appointed whether or not there's a will. A *special administrator* (or the equivalent) is a temporary fiduciary appointed by the court in many states to marshal and preserve the assets when a delay is foreseen in appointing a permanent fiduciary, perhaps due to a will contest or problems serving notice on interested parties.

When there's a will

In the case of a will contest, a person having an interest in the estate can file a petition for special administration in the probate court, along with a certified copy of the death certificate. The petition must certify that the Division of Medical Assistance has been sent, by certified mail, copies of the petition and the death certificate. The petition should also name exactly what powers are being requested. Without specific court authority, the power of a special administrator is quite limited. If all interested parties assent to the petition, it can be

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allowed without having to publish a legal notice in a local newspaper. But, even without assents, the judge may allow the petition. Although the named executor sometimes files the petition, in the case of a will contest there may be objections, in which case a disinterested third party may be appointed. The period of appointment can be quite brief, up to 90 days, except in unusual circumstances, in which case the court may make an appointment for an indefinite period.

Check with your local court to see if special administration or its equivalent is available in your jurisdiction, and for the specific local requirements.

When there's no will

If the decedent died intestate, special administration, or its equivalent, is the only form of temporary administration available. Temporary administration may be sought because of a delay in giving notice to all the interested parties, or because of a dispute over who is to be appointed as permanent administrator. Special administration may be asked for to administer assets, or to open a safe deposit box. All relevant information from the preceding section applies here also. Again, check with your local court to see what type of special administration is available to you.

Determining domicile

Knowing where the decedent's *domicile* (where the decedent had his or her primary residence) was at date of death is key when figuring out where you must probate the assets and what state you must pay taxes to (although real estate is subject to state estate or inheritance tax, if any, in the state in which it's located). All real estate in the decedent's state of domicile and all other tangible and intangible assets located anywhere in the United States are subject to probate in the decedent's state of domicile if all other requirements for probate are met. Only after you've made that determination can you begin primary probate in the correct court and ancillary administration in any other state where the decedent owned property. (Check out the next section for more on ancillary administration.)

It may seem odd to even question where the decedent lived at the time of death, but often the decedent's official home may not have been where you thought it was and so much of estate administration rests on the decedent's legal home.



In many instances, determining domicile is as easy as can be. Uncle Jim was born on the farm, worked on the farm, and you buried him from the farm (and maybe on the farm, as one of us can bear witness to) after he died. The farm was, without question, his domicile. But in many cases, people own real property in more than one place, and even more than one state (or country), and they pay taxes in more than one state at any given time. If you're responsible for administering an estate that owns real estate located in multiple places, how do you know where to initiate probate?

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The list of items used to determine domicile is long, and far from absolute. Certain items on the list may indicate one legal home, but others may show a different one. You have to make the final determination based on the weight of the evidence. Be prepared to back up your results to the state(s) that loses; for the states in question, large potential tax revenues may lie in the balance.

Evidence used to determine domicile includes the following:

- **Address of residence where the decedent lived more than 50 percent of the time.**
- **IRS office where tax returns are filed:** For example, if you live in Florida you file your tax returns with the Atlanta office; if you live in Vermont, you file in Andover, Massachusetts.
- **Place of religious affiliations:** Evidence of memberships in churches, synagogues, or mosques can be crucial.
- **Car registration:** People rarely register their cars in a state where they only live part time.
- **Voter registration:** You often have to show proof of residence in order to register to vote.
- **Address shown on passport:** Of course, passport addresses aren't updated when you move, but if the address matches the domicile you want to establish, so much the better.
- **Bank accounts established in local banks:** Although with the rise of interstate banking, this isn't as stellar a form of evidence as it once was.

Declarations of homestead are required in some states to protect your primary residence from creditors or to give you a lower tax rate, and if you find one attached to a tax return or stashed away in a file somewhere, it can go a long way toward supporting your argument that the decedent was domiciled in a particular state.

Accessing ancillary administration

If every decedent had only one residence or owned real estate in only one state, your life as executor would be much easier. But that's often not the case. When you're administering an estate with real estate located in a state other than the decedent's state of domicile, you have to have *ancillary* (that is, not the primary) administration in that state, but only with regard to that real property. *Ancillary administration* is an additional probate procedure in a state other than that in which the decedent was domiciled.

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You usually only need to have ancillary administration if the decedent held real estate that's subject to probate (if held in decedent's name alone or as tenants in common) in another state. In that state the will is referred to as a *foreign will*, and you're a *foreign executor.* As such, you may need to appoint an agent who is a resident of that state for *service of process* (procedure used to give legal notice). You provide the foreign court with an authenticated (by the court) copy of your appointment as executor and of your bond, and follow that court's procedures for distribution or sale, whichever you need to accomplish, of the real estate.

All other tangible and intangible assets, whether located in the state where the decedent resided most of the year, in another state (or even country) where the decedent lived part of the year, or even in a third, non-related state, are subject to probate in the decedent's state of domicile.

So for example, if your decedent lived in Massachusetts but had bank accounts in Florida, the Florida bank would recognize your authority as executor appointed in Massachusetts, and deliver the contents of those accounts in accordance with your instructions.

Eyeing whether you need a guardian

In some cases the court appoints a guardian to take care of a person's affairs. We're focusing our discussion on the case where a guardian is needed because the decedent has died and the heir (usually a minor child or an otherwise legally incapacitated person) needs a guardian because he or she stands to inherit from the estate.

When the parent of a minor dies, if the parent had a will, typically he or she names the surviving spouse (or in the case of divorce, the child's other parent) as guardian, or if there is none, some other person or persons (sometimes a husband and wife). Occasionally a parent will designate one person or couple as guardian(s) of the person of his or her minor child, and another person as guardian of the property. This is likely to happen if the decedent feels one person or couple is ideal to raise the children, but not the best person(s) to manage the child's assets.

If no guardian is named in the will, or if there is no will, the court will choose the guardian, taking into account the best interests of the child. It is always best for all involved if the decedent names a guardian in a will, as the probate judge will try to honor the decedent's wishes if at all possible. In many states, judges must follow the stated wishes in the will; in others, the judge makes the final determination based on a number of factors, of which the stated wishes of the decedent are only one.

If the decedent didn't name a guardian and there is no surviving spouse (think common accident or natural disaster, so neither parent survives), it is quite common for several relatives to come forward requesting to be appointed guardian, all claiming that they are the best person to take care of the minor child or children. In that case, the judge will take input from all sides and make a decision based on the child's best interests, and, if possible, taking into account the preference of the child.

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Deciding on Voluntary (Informal) Administration and/or Formal Probate

After you determine the estate includes probate assets, you have to decide whether you need to embark on the full administration process or if a special, informal form of administration is available to you in your decedent's state of domicile (or any other state where administration is required). That decision is fairly straightforward and this section helps you make it.

Going the voluntary route

If your decedent's probate estate (assets in his or her name alone, payable to the estate, or held jointly for convenience only) is of limited size, it may qualify for a special, streamlined form of administration whether or not your decedent left a will. This streamlined administration can save you time and the estate money. For instance, in Massachusetts you may seek *voluntary* (also referred to as *informal*) executorship if the decedent dies with a will and leaves only an automobile and personal property worth $15,000 or less.



To take the voluntary journey, you need to do the following tasks:

1. **You, the named executor (or certain related persons, as administrator, if there is no will), file a voluntary statement with the probate court.**

   Complete a form provided by the court regarding the decedent, his or her assets, heirs at law, devisees and legatees (if a will), and surviving joint owners of property.

2. **You must certify that you sent the State Division of Medical Assistance copies of the statement and the death certificate by certified mail.**

3. **You must also file the original will (in the case of executorship) and a certified copy of the death certificate.**

   If someone else doesn't file a petition for formal probate of the will and all other requirements are met, the court may attest a copy of the statement and/or issue a certificate of appointment to you as executor/administrator, and you may then act without further court involvement to pay the expenses and debts of the decedent and distribute any assets. (Note that a voluntary statement, or its equivalent, can't be filed just to open a safe-deposit box; for that you need to go for temporary executor or special administrator, as we discuss earlier in this chapter.)

   These steps are minimal compared with formal probate proceedings. Check with the probate court of the jurisdiction where your decedent was domiciled to see if your decedent's estate qualifies for this streamlined form of administration.

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Voluntary administration can be quick and reasonably painless if you're eligible to use it, and using it makes sense. One of us probated her grandmother's last will from soup to nuts in one day by using voluntary administration. It was a marathon, running from attorney to court to family members for signatures and back to court, but it was only one day. By comparison, had full probate been required, the entire probate process would have taken more than a year to complete.



Some states may have situations in which you want to proceed with formal probate for your decedent's estate even if informal administration is available. For instance, if you want to start the clock running for any creditors of the decedent to file claims against the estate, use formal probate proceedings (see the next section), which involve publication of a notice to creditors of the deadline for filing claims against the estate (such as four months from the notice, depending on your state law). This notice protects the estate and you as the executor/administrator from any later creditor's claim. With voluntary probate, no such notice is given, and thus the period for filing claims against the estate may never close. You may say, "Who cares, this estate doesn't have enough assets to pay creditors anyway," but some non-probate assets may be subject to the claims of creditors in your state, especially any assets held in the decedent's revocable trust at death. Other states leave the burden on the creditor to be aware that the decedent has died; these states simply allow a period of time, such as one year after the date of death, for creditors to file claims with the probate court.

Treading the formal route

If the assets of your decedent's estate are more than the minimal amount provided for under a special administration statute, you need full, formal probate — the whole shebang.



Don't be intimidated. Your state statutes and probate (or equivalent) court rules spell out the steps needed to probate the decedent's will in your state. But be warned that although the probate court registers and other court employees can be very helpful, if they feel you're trying to use court staff to help you tackle a task that requires a probate attorney, their patience may wear thin. If you're administering an extensive estate, make sure that you consult an attorney who specializes in estates. Even if you use an attorney, you want to understand what's going on in the probate process, so the following section lays out a typical probate process (although the process varies state by state).

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Petitioning for Probate of the Will

The probate process may be a stressful experience that sometimes makes you feel like you're never going to close the estate. If the estate you're administering needs formal probate, you want to follow your state's statutes to guarantee that all your hard work will pass legal muster.



To start the probate process, the following outlines a straightforward petition for probate of a will. These guidelines can vary state by state; we use Massachusetts as an example here. Check with your local law and practice for what may be specific to your state and probate court.

1. **File the decedent's will and any codicils, as well as your appointment as executor, in the probate court in the county where your decedent was domiciled at the time of his or her death.**

   Codicils are supplements or additions to the will. If you're not a resident of the same state as the one where you're initiating probate, you need to check with the court to see whether you're allowed to act. Frequently, you'll be allowed to do so if you appoint a *resident agent* in the state of domicile before you become executor. The purpose of the agent is to be an in-state presence to receive service of process on your behalf, if necessary (think disgruntled beneficiary suing executor; not that that would ever happen to you). By the way, even though we are addressing you as executor, keep in mind that federally chartered national banks, in-state banks, and in-state trust companies can also act as executors, as can foreign (out-of-state) banks or trust companies, under certain circumstances.

2. **Sign a bond and submit it with your petition.**

   The petition typically requests your appointment with a *bond* (your written pledge to guarantee your performance as executor); whether or not you need a *surety* (a company that the estate pays to guarantee your bond) on the bond will depend both on state practice and on whether your decedent requested in the will that no sureties be required.

3. **Certify that you've sent copies of the petition and death certificate to the Division of Medical Assistance by certified mail.**

4. **Make sure you list the following interested parties on the petition:**

   - Heirs at law (those who inherit by statute in your state if the decedent left no will) and next of kin (nearest blood relatives, as defined by state law), but not beneficiaries under the will (they have no standing until the will is allowed).
   - The state attorney general if there are no heirs at law or if there are any charitable bequests in the will.

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- If the decedent's surviving spouse is incompetent and isn't represented by someone other than you as executor, *a guardian ad litem* (a special guardian appointed by the court) on his or her behalf needs to be a party to the petition.
- If a *pretermitted heir* — a child or descendants of a deceased child not provided for in the will (unless the omission was clearly intentional) is under a disability, such as being a minor, a guardian ad litem is required.

If an interested party is in the military, special provisions usually exist to ensure that that party is represented.

5. **Provide a copy of the court notice of the petition for probate to all interested parties as well as all devisees and legatees.**

   All the interested parties listed on the petition for probate, and, typically, all devisees and legatees under the will (even though they aren't legally considered interested parties) get a copy of a court notice (sometimes called an *order of notice* or *citation*). The citation provides that any interested person who wants to object to the admission of the will to probate do so by a given date. Publication in a newspaper that publishes legal notices is also required. (Chapter 8 discusses in more depth publication in a newspaper.) Your court's rules determine your method of delivery to all interested parties. In some jurisdictions, you must send the notice by ordinary mail to all interested parties. Some jurisdictions also require that the interested parties receive a form providing information regarding their rights.



   Determining who receives notice under what circumstances is the stuff of which charts are made for probate attorneys, so don't hesitate to turn to the court or your probate attorney to make sure that all receive notice who should. Should you give notice and inadvertently miss someone who was required to receive it, you may have to begin the entire notice procedure again.

6. **Indicate that you've published and mailed the notice as directed by the court and filed the citation with the return of service section completed with the court.**

   In some states the citation has a "return of service" section that makes this process easy. Otherwise, follow your court's rules for showing that you've published and mailed the notice as your court requires. Act carefully, because if you don't make return of service exactly in accordance with the citation's (or your court's) directions, you must apply again to the court for a new citation and return day.

7. **Get the will proved.**

   If no one has filed an objection to the allowance of the will, it may be *proved* (that is, allowed as the decedent's last will and testament) in a number of ways, including the following:

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- If the decedent's surviving spouse (if applicable), heirs at law, next of kin, and any other interested parties have all agreed to the allowance of the will without testimony (a statement to this effect must appear on their assents), you may request that the petition be allowed without testimony.
- If one of the witnesses to the will signs an affidavit before the probate register or assistant register regarding the facts of the execution of the will.
- If one of the witnesses to the will gives oral testimony before a probate judge regarding the facts of the execution of the will.
- The easiest method of all: If you're lucky enough to have a (physically attached) self-proving affidavit that was executed by the decedent and the witnesses when they signed the will, just file it with the court, and the will is proved! (This method is available in Massachusetts and a number of other states.)



In some states, in certain circumstances, a *holographic* (handwritten) will is admissible. Be aware, though, that holographic wills may appear out of the blueafter death from an unanticipated source and are sometimes forgeries. One of us administered an estate that had a will contest that dragged on for years, with one of the wills in question being a holographic will that the decedent had never even signed. The fact that everyone involved suspected the will was fraudulent didn't stop it from mucking up the works on what was already a complex situation.

Petitioning for Administration When You Don't Have a Will

If your decedent died *intestate* (without a valid will), you have several options available, depending on your state. Informal administration is available in some small estates whether or not the decedent left a will. It's a separate proceeding from the one for voluntary executorships, which we discuss earlier in this chapter. Appendix B gives you an overview of intestacy laws state by state.

If someone dies without a will, you may wonder who can file a petition to serve as administrator. It varies some by state, but under Massachusetts law, which is fairly representative, the following persons (in this order) may act as administrator unless the court decides to appoint someone else:

- The decedent's surviving spouse, if any.
- The decedent's next of kin (those entitled to inherit under the statutory distribution laws for intestate estates) or their executors or administrators.

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Be ready in case someone ever contests the will

Just because the decedent's will names you executor doesn't mean the court will appoint you to act. Any of the people you've given notice to or anyone else who feels the will isn't valid can object to its allowance, although these *will contests* aren't an everyday occurrence.

The bases on which a will may be deemed invalid include the following:

- If the decedent wasn't mentally competent or of sound mind (having *testamentary capacity,* or the ability to know and understand the will's contents or that he or she was even making a will in the first place) during the signing of the will.
- The decedent made the will in accordance with another's wishes rather than his or her own free wishes, officially known as *acting under undue influence from another.*
- The decedent's signature is shown to be a forgery.
- Evidence of a later will replacing the will in question.
- The will wasn't executed (signed and witnessed) in accordance with state law.

If you're the executor of a will that gets contested, consult an attorney with experience in will contests. Sometimes the attorney who drafted the will is best suited to defend it because he or she was most familiar with the decedent's wishes, state of mind, and the circumstances of its execution. In any event, let the attorney handle the will contest, keeping close tabs, of course, on its progress, and carry on with the estate administration after it has been settled (assuming you're still executor!). If there are pressing issues that can't wait, such as the administration of estate assets and the filing of tax returns (a will contest can drag on a long time), be sure that the court has appointed a suitable person (it may not be you, because the will is being contested) as special administrator.

- If none of the above is competent, all renounce administration, or all neglect to take administration within 30 days after the decedent's date of death, one or more of the decedent's principal creditors (after public notice).
- If no spouse or next of kin, a public administrator may be appointed.
- In practice, most probate courts allow a petition for appointment of a person not listed here if the surviving spouse or at least one of the next of kin brings the petition or assents. Trust companies, national banks, and even some foreign banks may also act.

Various states have their own additional criteria. For example, in many states, anyone with an interest in the estate who isn't under indictment for, and hasn't been convicted of, killing or helping to kill the decedent may file the petition. We sincerely hope this isn't an issue in your decedent's estate! The commissioner of revenue may also file in certain circumstances. Check your local law for similarities and differences.

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The procedure for allowance of a petition for administration carries with it all the same, or similar, requirements to the petition for probate of the will regarding interested parties (except with no named beneficiaries), notice, return of service, and presentation for allowance. Whether or not the bond has sureties and whether personal sureties are acceptable in place of corporate sureties depends on different factors such as the existence of a will and on each court's discretion.

Eyeing Surviving Spouse Decisions

Surviving spouses may have some important decisions to make with regard to the will and the decedent's estate. This section highlights a few important decisions the surviving husband or wife needs to make when the decedent has died and probate has begun. These decisions are all part of the probate process if the surviving spouse decides to act on them, but they bear no relation to whether the surviving spouse is executor. It is, however, your duty as executor to inform the surviving spouse of these rights as soon as possible after the death of the decedent.

Electing against the will

The surviving spouse has the right to *elect to take against the will.* In other words, instead of receiving what the decedent left to him or her as a beneficiary under the will, he or she may choose to receive instead what that surviving spouse is entitled to under state law; his or her *statutory share*. The statutory share isn't the same as the *intestate share* (what the surviving spouse would have received had the decedent left no will).



Because you, as executor, represent the estate and not the surviving spouse, you should not advise the spouse on whether to accept the will's bequest and /or devise or to take the statutory share. However, be sure the surviving spouse is aware of this right.

In some jurisdictions, a spouse electing against the will just has to file a document waiving his or her share under the will and claiming the statutory share within a set period after the allowance of the will. Electing to take against the will is an all-or-nothing proposition; the surviving spouse can't cherry-pick, accepting some provisions, but not all. If the decedent and the surviving spouse prepared their estate plan documents together and were in agreement on their plans, such an election is unlikely.

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Electing to take against the will has many consequences, some of which may not be readily apparent. For example, if the decedent exercised a *power of appointment,* (which we explain in Chapter 17) in the will over a trust in favor of the surviving spouse and the spouse elects against the will, the spouse also loses the property subject to the power of appointment. The estate tax consequences of a waiver should also be kept in mind (the marital deduction will be affected), as should the fees and expenses involved in dealing with the waiver and its results.

Requesting a surviving spouse's allowance

The surviving spouse may have the right to a *surviving spouse's allowance* for the period of the administration of the estate. In our experience, the allowance is minimal and usually isn't considered worth applying for, but if your decedent left a surviving spouse, be sure to check your state's laws to see what may be available to him or her. For instance, in Massachusetts, the allowance is limited to necessities and apparel plus the right to live in the decedent's residence for six months after death, and the amount awarded can be as little as $100 and usually not more than $1,000. If no spouse survives but minor children do, the kids may receive up to $100 per child. The spouse makes the claim by petition to the probate court.

Claiming dower

Statutory dower (governed by legislated law) exists in many states to replace *common law dower* (governed by customary law) and *curtesy*. *Dower* is the right of a surviving spouse to an estate for life in a portion of the property owned by the decedent at death, subject to any encumbrances on the property. ***Translation:*** The surviving spouse gets the use of, for instance, one-third of the real estate for life. Depending on what the real estate is, that use could be, for instance, to live in one-third, or collect one-third of the rents, or receive one-third of the profits from the crops grown on it. Although dower originally only applied to widows, it now applies to widowers as well, because common law *curtesy* (the right of the widower to the use of all the wife's real estate for life) has generally been abolished.

To claim dower, the surviving spouse files a claim in the probate court within a fixed period after death. If dower is claimed, the surviving spouse must also waive the will (if applicable) and take his or her statutory share. Few spouses actually find it beneficial to claim dower, because they've planned their wills together and don't have a reason to take against the will, and dower is a clumsy means of inheritance. Someone may choose this option if his or her deceased spouse didn't include them in his or her estate plan; if so, this is the only means by which the surviving spouse can receive an inheritance.

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Chapter 7

Marshalling and Liquidating Assets

In This Chapter

- Figuring out what the decedent owned
- Taking stock of the big-ticket possessions and other assets
- Keeping tabs on the household items
- Getting property appraised
- Checking for employee benefits, insurance policies, and miscellaneous death benefits
- Taking a probate inventory
- Selling what needs to be sold

Marshalling the assets brings to mind wonderful pictures of bank accounts, cars, houses, and the beautiful barometer on the wall all standing in an orderly line, just waiting for you to acknowledge and count them. As the executor of an estate, your first job is to *marshal* the assets — to determine what exactly the *decedent* owned on the day that he or she died. In this chapter, we discuss step by step the best ways to search for each type of asset. Your ease in finding all the assets depends, to some degree, on how well you knew the decedent (for the more obvious assets) and on the decedent's state of mind at the time of death. Someone who suffered from Alzheimer's disease or another form of dementia may well have done unusual things with his or her assets or asset records (including disposing of them).

As you figure out what the decedent owned, you also come across what the decedent owed. Debts of the decedent or claims against the estate come to light in several ways. You may find record of them in the decedent's papers, receive bills in the decedent's mail, or hear from a creditor as a result of notifying creditors as your local probate court requires (typically by publishing such a notice in a local paper). You may even get a knock on the door or hear from a friend or relative from whom the decedent borrowed money. See Chapter 8 for details on paying creditors.

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Understanding Why You Need to Inventory What the Decedent Owned

Most decedents won't have had the foresight to leave you an *inventory*, or list, of their assets with a helpful notation of where each asset is located. One of our aunts (who lived to be 101) made a hobby of it, but in our experience, she's the exception. More common are decedents who not only didn't plan but also couldn't possibly have told you everything they owned. Still, in order for you to carry out their wishes and fulfill the requirements of the probate court, your job is to look under the sofa cushions, check under the floorboards, and behind not only Door One but also Doors Two and Three in order to find everything owned by the decedent on the date of his or her death.



Whether you're handed a helpful list or need to start excavating on your own, your starting point in organizing an estate and planning its administration is to locate and list all the decedent's assets. From this inventory, you're able to determine whether probate of the decedent's estate is necessary (depending on whether or not the decedent owned property in his or her name alone). If the total value of the probate assets is small enough, you may be able to do a simplified version of the probate process. Otherwise, you'll have to go through full probate. Not to worry though, the probate process itself isn't really so bad. We guide you through the entire process in Chapter 6.

So if you're wondering about what some of the items in this chapter are and why you need to include them in your list of estate assets, don't worry. Although some of these items may be unfamiliar to you, we have you covered. They all appear on **Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return**, which we describe more completely in Chapters 16 and 17.



As you create your list, be sure to note the name in which each asset is held. For instance, an asset may be held in the individual name of the decedent, jointly with one or more other people, in trust, or in partnership. You need to know this to decide whether the asset must be probated (if in decedent's name alone, held as a tenant in common, or jointly for convenience only). See "Preparing and Filing the Probate Inventory" for more info.

Observing the Obvious: Big-Ticket Items

When you list the assets, the big-ticket items are probably one of the easier places to begin. Some assets, such as the decedent's home, are so obvious that they present themselves to you on a silver platter, so to speak. This section identifies these bigger items and tells you how to handle them.

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The bricks and mortar: Real estate

When you think of an estate, the first picture that pops into your mind may be a home. However, regardless of whether the decedent owned a big home, a smaller condo, or a vacation home in Bora Bora, you need to locate all the real estate.



To find all real estate the decedent owned at death, look to where he or she was living. Look for deeds, tax bills, mortgage statements, and insurance policies that refer to the residence and show who exactly owned it — the decedent alone, jointly (with a spouse, a child, or some other person), or in trust or nominee partnership. In each case, the deed is key because it shows who owned the real estate.

If the deed is in the decedent's name alone, the property is part of the probate estate (even though in Massachusetts, at least, the title to the property vests in the heirs immediately upon the death of the decedent (subject to the claims of creditors, estate taxes, and the like).

Things that move: Cars, boats, and cycles

Cars, boats, motorcycles, and other vehicles may be sitting quietly in the decedent's driveway or at the dock, making them easy to locate. In that case, locating the registration and insurance documents helps you determine whether the decedent owned them in whole or in part. In some states, title to the car passes automatically to any surviving spouse (unless the decedent disposed of the car otherwise in his or her will), thus avoiding the need to probate the vehicle and giving the surviving spouse quick access to a car he or she may need to use.

However, the car still needs to be reregistered in the surviving spouse's name, and the automobile insurance must be changed to reflect the new owner. Check with your state's Department of Motor Vehicles, Registry of Motor Vehicles, or the equivalent agency to determine the procedure in your state.

Small (And closely held) businesses

If the decedent was the owner, in full or part, of a small business, your job as executor is not only to value the business as of the date of death but also to figure out whether to continue the business or sell it now that the owner has died. You need to know how the business is set up before you can decide what to do with it. Businesses may be set up in the following ways:

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- **Sole proprietorship:** The most common form of small business ownership, the *sole proprietorship,* is an unincorporated organization that is accounted for entirely on Schedule C of the decedent's Form 1040. The company may do business under a name other than the taxpayer's (sometimes referred to as a doing business as [D/B/A]), and it may even be organized as a Limited Liability Company (LLC). It may even have its own Employer Identification Number (see Chapter 18). If the decedent's business is reported on Schedule C of the 1040, you're dealing with a sole proprietorship or an LLC where the decedent owned the entire business, and you need to value it as such.
- **Partnership:** If the decedent held a partial interest in a business, the business may have been formed as a partnership. Once again, the best way to find exactly how the business was organized, and how it's currently operating, is to locate the decedent's tax returns and look for the partnership entry on Schedule E. A decedent's tax return is the road map to determine what businesses the deceased had an ownership in. After you determine that the deceased had a partnership interest, you can then get a copy of the most recent partnership tax return (Form 1065), which tells you not only what percentage of the partnership the decedent owned but also exactly how the decedent held title in that property. If the partners had a formal partnership agreement, it may include a provision for the surviving partner(s) to buy out the decedent's partnership interest, including a formula for setting the buyout price. Or they may have a separate buy-sell agreement. In the case of a sale, your job is to obtain the best price possible. This price sets the value for estate tax purposes if it reflects the fair market value of the partnership interest. The partnership may dissolve upon a partner's death if the agreement doesn't contain a provision to the contrary.
- **Subchapter S corporation:** These types of businesses are very popular because only the shareholders pay income taxes on profits instead of paying tax first at the corporate level and then again when the profits are paid out as dividends. Your decedent's most recent income tax returns should tell you whether he or she was an S corporation shareholder; you can make certain by reviewing the corporation's income tax return (**Form 1120S**).



Because you can transfer S corporation shares only to an individual or to a qualifying trust (see Chapter 3 for which trusts qualify), you need to tread carefully when dealing with these shares. Selling or otherwise transferring shares to a nonqualified shareholder can cause the corporation to lose its S status. Because you can't change the terms of any trusts created by the decedent to make them qualifying trusts, be alert for this pitfall. The shares of stock that the decedent owned in the Subchapter S corporation require valuation by an expert unless a buy-sell agreement is in place that fixes the formula or purchase price of the decedent's stock by the remaining stockholders on his or her death. For the estate's purposes, that price or formula is fair market value.

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- **Closely held C corporation:** If the decedent owned stock in a non-publicly traded company, and it's not an S corporation, you're looking at a closely held (or privately held) C corporation. With a C corporation, you don't have any income tax concerns about who may inherit the stock. As with other privately held businesses, the corporation may have a buy-sell agreement that sets the price at which the other stockholders may buy the C corporation stock. This agreement sets the stock's value for estate tax purposes, if the IRS considers the price fair market value.

Tracking Down All the Other Assets

You don't need to be a detective to find all the decedent's assets, but an inquisitive mind and a good imagination often help. Family knowledge or lore about what the decedent owned can be handy. For example, in one estate we're familiar with, the family was well aware of the decedent's collection of valuable jewelry. After she died, however, the jewelry was nowhere to be found — that is, until an estate administrator, on the second or third search of the home, touched a loose board in a wall and found it. Consider this section your Sherlock Holmes 101, where we provide you some tips on sleuthing and uncovering all the assets.

Reading the mail

Despite everything your mother told you about how rude reading someone else's mail is, this is one time when it's not only permissible, it's also admirable. As you read the decedent's mail, you may find references to many assets, including bank accounts (from bank statements), the safe-deposit box (from any rental bills), real estate (from real estate tax and insurance bills), stocks and bonds (from dividend and interest checks, brokerage statements, mutual fund statements, retirement account statements), and correspondence regarding other assets.



Checking the mail isn't just a great way to figure out what the decedent owned; it also works well for eliminating items that may have been on your preliminary list (perhaps the decedent had told you about something years ago) but no longer exist. More than one administrator has been surprised to find that longtime family heirlooms now belong to someone else. The following sections describe two types of mail you especially want to focus on.

Bank statements

Make no mistake about it: Bank statements contain a wealth of information. Not only do they give you account numbers and at least an idea of how much value the accounts contain, but they also let you know how the decedent held title to the accounts. He or she may have owned it outright (in his or her

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name alone), with another person, or even through a trust. Although his or her recollections while alive may be a bit sketchy, your task is much easier after you have your hands on at least one statement from each account. Armed with a copy of your appointment by the probate court as executor (see Chapter 6), you have no difficulty in obtaining the most current statements, as well as any prior statements you need.



If you manage to uncover the bank statements for the checking account, you've hit pay dirt! Our experience is that, especially as our clients and family age, their once-pristine check registers become, well, less pristine, and determining what their typical monthly bills look like is often difficult. With the checking account bank statements in hand, figuring out who's been paid, for what period, and who's still waiting (often very patiently!) is easier.

Banks issue statements periodically (usually monthly, but sometimes quarterly) and not always on the last day of a month. In your initial search for assets, you want to find the one dated most closely to the date of death to give you a general idea of the value in the account on the date of death. As soon as you know the asset exists, contact the bank directly in order to get an exact balance, including any accrued interest, as of the date of death (you need the balance with interest for both the probate inventory (see "Preparing and Filing the Probate Inventory" in this chapter) and the Form 706. And don't forget the online bank accounts! (Check out the "Breaking into computer files" section for more info.)

If you're not sure whether you've found all the bank accounts, write a letter to each local bank (and each bank in any city where the decedent has a vacation home) inquiring whether it houses any accounts (or safe-deposit boxes) in which the decedent had an interest. You should get full cooperation if you include a copy of your appointment as executor.

Brokerage statements

As good as finding the bank statements feels, finding the brokerage statements feels even better. In most estates that contain any valuable property outside of real estate, brokerage accounts are where you find most of it. Identifying where those accounts are, and in whose names they're registered, takes you a long way toward compiling a complete list of what the decedent owned. Don't forget the online brokerage accounts, either!

Brokerage statements typically give you the market value of the individual securities on the statement date. Because determining the general size of the entire estate relatively quickly is important (you need this information to figure out whether you have to do a full probate or not), find the statement closest to the date of death to get a general sense of what these assets were worth on that date. Chapter 17 tells you how to determine the actual value (down to the penny) of these assets as of the date of death.

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Perusing other personal papers

Although you may feel like you're invading the decedent's privacy by rummaging through his or her desk and computer, put those feelings aside. You need to uncover everything about the estate. As you dig, you may find such treasures as safe-deposit box keys, jewelry appraisals, insurance policies (sometimes with riders cataloguing personal and household items of unusual value, in the case of homeowners' policies), references to real estate, rented storage facilities, and even stock certificates and registered bonds that the decedent didn't put away for safekeeping. Keep an open mind; as many estates as the two of us have been involved in, we're still constantly amazed at what people stash. What may appear to you as a jumble of worthless paper may contain such gems as bearer bonds, savings bonds, and bags of unset diamonds. You never know until you dig; dig methodically and carefully. Never throw out any piece of paper (or bag of trash) without reviewing it for clues to estate assets.



We'd love to be able to tell you that no one ever tried to take advantage of Uncle Henry's death to weasel out of money owed but, unfortunately, we can't. In your search through the paperwork and records, you may find that Uncle Henry made loans to family members that he always intended to collect on. Any loans, notes, or other debts owed to the decedent are assets of the estate, and your duty as executor is to include them on the inventory, along with interest accrued through the date of death. You must then pursue the collection of the note or debt.

If you find documents for such a loan (a promissory note, perhaps, or even a mortgage), they remain in force even after Uncle Henry's death unless there's specific language in the documents or in his Last Will that forgives them upon death. If the documents exist and this language doesn't, these loans are assets of the estate, and the estate administrator (that's you) must enforce the terms. Not doing so leaves you open to accusations by Uncle Henry's other relatives or heirs that you've failed in your duty as a fiduciary.

Finding the hiding places

People stash what they perceive as valuable in different ways and places; your job, as the executor, is to insert yourself into the thought processes of the decedent and attempt to find all these hiding places. For example, one of us keeps her personal papers in the bottom drawer of a locked filing cabinet, in a locked fireproof safe, and scattered around her desk. Savings (such as they are) are littered on the floor in the form of loose change, and jewelry is spread here and there among no fewer than seven jewelry boxes and old tool chests. The other of us just has the locked filing cabinet. As the executor, you have to find everything applicable for the estate, and your search needs to include the following:

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- **House safes:** Many houses have safes drawn into the plans, and some have safes built in later; most of the time, though, the house safe is a locked, fireproof box that's stashed in some out-of-the-way place, with an eye to keeping certain documents and other valuables free from prying eyes and catastrophic acts of nature. Unfortunately, the location of the house safe isn't usually at the forefront of the mind of someone about to die, and so after death, the search is on. Check closets, drawers, under beds and dressers, and in the attic and the basement. Be sure to check the freezer (especially the freezer chest out in the garage that hasn't worked for years). Don't assume that because a place looks too dark and dingy to ever be considered as a hiding hole that it's not.

  After you locate the safe, you need to have the lock professionally attended to if it's locked and you don't have a key or the combination. The locksmith will need a copy of your appointment as executor to open the box. You probably also want an additional witness with you so that you have an extra set of eyes to note what's in the box and, more important, what isn't. Make an inventory of the contents of the box as soon as you open it, sign the inventory, and have the second person sign it as a witness to the contents.

- **Other unusual spots:** Don't beat yourself up if you fail to find everything that the decedent stashed. Do, however, make sure that you've at least made a reasonable search for anything that may be either intentionally or unintentionally hidden. We've all heard tales about buried treasure located under the floorboards or the mattress. Well, the tales are often true, either because the decedent didn't trust banks to keep money safe or through accidental circumstances, such as a piece of jewelry slipping off unnoticed and being found in the backyard or the back of a closet years later, when you're really searching for estate treasure. One of us worked on an estate where more than $20,000 in cash was found stashed behind the kitchen stove, behind a loose brick in the fireplace, and literally under the floorboards. Although the decedent also had the requisite number of bank and brokerage accounts, the money discovered in the house represented more than loose change.

  One of our grandmothers had a habit of burying silverware she couldn't adequately clean. Although we dug through all of her houseplants and the garden before she moved, we never recovered all the missing spoons. We did, however, find a gold chain she'd lost many years earlier, one which, when we had it appraised, was worth more than $5,000.

Emptying the safe-deposit box

Locating and emptying the decedent's safe-deposit box (if he or she has one) is a key step in finding the valuables in the estate. The quickest way to find the box is, of course, to ask the question before death; if you forgot to have that conversation before it was too late, not to worry.

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Most people choose to rent a safe-deposit box in the bank where they do the majority of their business, so check there first. You may find a record of the box, either in a notation somewhere or in a paid bill for the box rental, among the decedent's papers. If you don't find any record, you can approach the bank(s) directly and ask, after you've received your appointment as the estate's executor. Provided that the bank can see you have the authority to receive this information, it'll be happy to comply.

After you discover where the box is, you have to open it. If you don't have the key or the combination, you can have the lock drilled for a fee. Again, as long as you're armed with a copy of your appointment by the probate court, you'll find the bank very helpful in accessing the contents.



Don't open the box on your own. Take a witness with you and write down a list of everything inside. Even better, have the witness videotape you opening the box and what you find. Remember, when you're dealing with property that's not yours, especially property that may have significant monetary or sentimental value, you can't be too cautious.

You never know quite what you'll find in the safe-deposit box. Often, you come across jewelry, deeds to real estate, stock certificates, bonds, and perhaps even the original Last Will of the decedent. Other times, you find items that have no intrinsic value, and you wonder at their sentimental value as well. Quite frequently, you find that the box is empty. Until you open it, though, you'll never know.

Breaking into computer files

As computers become commonplace, they're an increasingly important resource for sorting out what someone owned; you need to be able to access the information on the decedent's computer. In most cases, the computer will probably give up its files fairly easily, but if the decedent was technically adept, you may have some difficulties in breaking through passwords and other safeguards. Far be it from us to advocate hiring a hacker, but you may find it helpful to use someone who is computer savvy in order to get to the information you need.



Before you begin digging for files, make a complete backup of the hard drive, and of any loose disks, flash drives, CD-ROMs, or DVD-ROMs you find lying about that contain data. You want to be cautious about losing data, and making backups ensures that you have the information that was most current on the date of death. The best, quickest way to back up any computer is to purchase an external hard drive, plug it in, and then use the software that comes with it to start backing up all the files located on the computer's hard drive. You can also copy the contents of floppy disks, CD or DVD-ROMs, and flash or thumb drives to the external hard drive to give you a complete copy of the decedent's computer files. If you're concerned about the cost of the

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external hard drive, don't worry — it's a valid expense of the estate (including the cost of a technician if you really don't want to do the backup yourself), and you should pay it from estate funds, not from your own funds.

You may find nothing of value on the computer, or you may find the decedent's entire financial life. As more people computerize their financial records and replace paper statements and bills with virtual equivalents, the computer may contain the only records of those bank and brokerage accounts. On the computer, you can see evidence of sources of income as well as debts owed. You can probably even find copies of tax returns. In fact, you can often find everything that used to be kept in a well-organized filing cabinet on the computer if only you take the time to look.

Checking over prior tax returns

When looking for a snapshot of someone's financial affairs, digging through the person's tax returns provides you with a mountain of information — you not only find sources of income and deduction, but you're also able to eliminate many items you thought he or she owned but actually didn't.

If you find paper copies of tax returns, you may be fortunate and find the supporting documents to those returns in the same spot. Those official little slips of paper (Forms W-2, 1099, and 1098) can direct you to the decedent's employer (if he or she was still employed at the date of death), as well as to all the interest-bearing bank accounts and dividend-paying stocks he or she owned. You can find evidence of retirement income and mortgages owed. In fact, depending on the complexity of the tax return and the amount of underlying info, you can gain a fairly clear picture of the decedent's financial life just from the tax return.



If you're unable to locate prior tax returns, either on paper or buried somewhere on the computer hard drive, all isn't lost. You can obtain copies of prior years' tax returns, including copies of all W-2s, 1099s, and 1098s directly from the IRS by filing **Form 4506, Request for Copy of Tax Return** and sending it, together with the fee of $39 for each year requested, to the IRS Service Center indicated on the form instructions. Remember to send a copy of your fiduciary appointment with the Form 4506; the IRS won't give you information if you're not authorized to receive it. If you don't need to see an actual copy of the entire return but only want to know the information that's on it, you can save the $39 per year fee by filing **Form 4506-T, Request for Transcript of Tax Return** instead.

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Listing Personal and Household Effects

The preceding section helps you establish at least a preliminary list of the decedent's financial affairs. Now you need to consider all the stuff you find in the decedent's residence(s). Everything the decedent owned outright on his or her date of death is now under your care as executor; you're responsible for making sure that you account for this stuff and that it ends up where it's supposed to. You need to prepare a detailed inventory of all the personal and household items (being sure not to include any that belonged solely to the surviving spouse). This inventory is necessary to put a value on the items for the probate inventory and the Form 706 (see Chapters 16 and 17).



If the decedent has a surviving spouse, the personal and household items may be staying in place after the decedent's death, except items the decedent specifically *bequeaths* (leaves by will) to others. If the decedent has no surviving spouse and the house needs to be dismantled, you still need to list and document everything and set aside anything of real value for later valuation.



Don't allow relatives and friends to rummage through the house and remove items until you've listed them, and if valuable, valued them. Seriously consider collecting all outstanding house keys immediately after the death or, even better, changing the locks as soon as is humanly possible. And if you don't get to the house until after Cousin Hester has emptied it with a moving van because she knew the decedent wanted her to have "a few special things," you'll need to try your best to either retrieve the items removed, or value what you remember and then charge that against Cousin Hester's eventual share of the estate (if she has one).

Most often, going through the personal and household property is an exercise in clean up and clear out. For most people, these tangible items, though they have great sentimental value, rarely have a correspondingly large cash value. Clothes, for example, are usually given to a local charity, and household furnishings that family and friends don't latch onto either follow the same route or are disposed of in a yard sale or on Ebay or Craigslist. Surprisingly, sometimes items you thought you'd have difficulty giving away are extremely popular; one of us had a bidding war for her grandmother's hats from the 1940s and 1950s, but this situation is more the exception than the rule.



Of course, not all the personal and household effects are intrinsically valueless, and your job is to separate out the wheat from the chaff. Just because something may not be your style doesn't mean that it has no value; in fact, we've found that some of the most hideous pieces of furniture are among the most valuable! Regardless of your personal opinion, you need to carefully check the furniture, the knickknacks, the dishes, what's hiding in the attic and

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the cellar, and the garage. If you're familiar with the contents of the house before inventorying what's there, you may want to obtain a recent valuation guide to gain some idea of what you're looking at and a rough idea of its value. If you know before you go into the house that it contains items of great value, you may also want to consider bringing an antique dealer or auctioneer with you to help sort out what has value from what doesn't.



Make sure that you have witnesses with you when you inventory and dispose of the contents of the house. If you can, take huge numbers of pictures or videos of each room before you move anything, so that, should someone take it upon themselves to question what was there when you opened the door, you have visual proof as well as third-party confirmation.

Appraising the Property

After you discover where all the assets are hiding, you need to determine what they're worth. Some are obvious (the unused postage stamps, for example, or bank accounts that only hold cash), although others are more difficult to pin down; you may have to call in experts to help you out.

Some property doesn't vary in price much from day to day or week to week, but the value of most property fluctuates. When appraising an estate, make sure to value the property as of the date of death, even if you're having it appraised months afterwards. Be sure to let your property appraiser know this stipulation in advance — her appraisal needs to explicitly state that the value is as of the date of death. This section explains what you may need to have appraised and how to do so.

Tangibles

Tangible property refers to both real estate (which we discuss separately) and other stuff — furnishings, jewelry, fur coats, cars, boats, collectibles, and artwork. If you can hold or touch it, and it's not securities or cash, you're holding tangible property.

You can take several avenues in valuing tangible property, provided that, whichever one you use, it's a reasonable approach. Some of the ways include

- **Do it yourself.** The Web has many resources to help you appraise a wide assortment of items. For example, if you want to reasonably appraise a collection of books, you can search for matching volumes in online auction sites and booksellers.

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Obtaining a value for the car is easy! Just plug in the make, model, year and condition into the Kelley Blue Book site on the Internet at `www.kbb.com`.

Turn to experts. If you need experts to assist you in valuing the tangibles, make sure that you hire someone who is truly an expert in the type of property you need appraised. For example, if you tried to value something online and you can't find an identical copy, say of the book (and identical matters — there's a huge difference between first and second editions), you may choose to take that collection to a rare book dealer, who'll be happy to appraise your collection in writing for a price.

If you need some antique furniture valued, make sure that you ask an antique dealer who specializes in the same type of furniture you have. (Asking a dealer who specializes in Louis IV furniture to appraise your aunt's collection of 19th century Japanese prints isn't the best choice.) Finding the experts you need can be as simple as word of mouth; if you're using an attorney for help with probating the estate, he or she may have a list of appraisers of various types of property that he or she has used in the past. You can also check in the local phone book under dealers or appraisers for the item in question and search the Internet for local appraisers. Asking that appraiser who specializes in Louis IV furniture for a recommendation of someone who specializes in Japanese prints can't hurt, either. Contacting a museum that contains items or works of art similar to yours can also lead to a recommendation of an appraiser. See Chapter 4 for more discussion of appraisers.



In the world of appraising, documentation is king. Be sure to obtain written appraisals from any experts you use, even if you must pay a fee. Likewise, if you're relying on other sources, such as online auctions, keep copies of your research in a file. That way, should someone question your valuation, you have proof of what the property was worth on the date of death.

Intangibles

Although valuing tangible property may give you scope for some creative research, calculating the value of an estate's intangible property, those bank and brokerage accounts, and any stocks or bonds that the decedent physically held, should speak to your brain's quest for absolute order. Provided that you have a complete list of the intangible property, figuring out what it was worth on the date of death should be a simple matter of math. So grab your calculator and get ready.

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Bank accounts

Figuring out how much was in each bank account on the date of death isn't too difficult. Just send a letter to the bank explaining what you want, together with a copy of the death certificate and your appointment as executor. Be sure to request the balance at the date of death plus any interest that has accrued between the last payment date and the date of death.

Remember, the decedent may have written checks prior to death that hadn't cleared the bank by the date of death. In this case, adjust for these withdrawals by subtracting them from the balance given to you by the bank. Of course, in the interest of showing all your work (make your former math teacher proud), list the bank's balance and then the offsetting checks.

Securities

Valuing securities, such as stocks, bonds, and mutual funds, isn't quite as easy. When determining their value, you're required to take an average of the high and low costs for the date of death and then multiply it by the size of the holding. For example, if your decedent held 50 shares of XYZ Corporation, and on the date of death, it traded at a high value of $50 and a low value of $40, the average cost per share would be $45. When multiplied by the 50 shares owned, the total value of that holding on the date of death would be $2,250. If the decedent died on a weekend or holiday, you have to average the average cost on the last trading day before death and the first trading day after death in order to arrive at the date-of-death value.

If the decedent held securities in a brokerage account, you may be able to obtain a valuation from the broker as of the date of death, especially if you ask for it as soon after the death as possible. Be certain the broker understands that this is a date-of death-valuation, though, because otherwise he or she will give you the closing price for that day, not an average of the high and low costs. Another source for the date-of-death high and low of a stock or bond is the *Wall Street Journal* issue from your decedent's date of death, which is available at your local library if you don't have a subscription. If you have access to the Internet, we also like Prudential-American Securities Inc. (`www.securities-pricing.com`), which can give you date-of-death values or alternate valuation for all stocks and bonds, including municipal bonds, for $4 per issue, with a minimum charge of $10. Remember, this fee doesn't come out of your pocket; it's paid for with estate funds.

Real estate

Assigning value to real estate may be the trickiest value to obtain because no two pieces of real estate are identical, and real estate is valued by looking at comparable sales. To value real estate, keep the following in mind:

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- Sometimes, you can use the assessment as the value at the date of death. The *assessed value* is the value your local real estate tax assessor places on the property for real estate tax purposes. Compare the assessed value with similar properties sold around the date of death or for sale at that time in your locale to see whether the assessed value is in the ballpark. If the values are comparable and the estate is small enough that it won't have an estate tax, using the assessed value works, because it clearly reflects the market value of the property at the date of death.
- If the assessed value in your area doesn't reflect the market value of the real estate (if you're unsure based on your market comparison, ask the local real estate tax assessor), have the real estate appraised, or use the following valuation methods to obtain a value for the probate inventory.



If a federal estate tax return (Form 706) is required, have the real estate appraised. As with all estate appraisals, hire a reputable appraiser who has experience in preparing estate appraisals. The appraiser typically refers to several *comparable* properties (that is, properties that have sold recently and are as similar to your property and as close in location as possible), in addition to other factors, in determining a value as of the date of death. The appraiser adds or subtracts value based upon the differences between your real estate and the comparable sales (for instance, an additional bathroom in your property increases the value; if your lot is smaller than the comparables, your value decreases) in arriving at a date-of-death value for your property.



Oftentimes, you have a buyer for the real estate before you have a chance to obtain an appraisal. Provided you sell it in an *arm's length* transaction (a transaction between the executor and someone who has no relationship to the executor or the estate) soon after death, you use the sale value as the date-of-death market value.

Contacting the Employer about Employee Benefits

Although the decedent's employer hopefully already knows about the death, in order to collect employee benefits, you need to formally contact the employer. A letter to the employer (and to former employers) inquiring about any death benefits should meet with full cooperation if you include your appointment as executor. Most likely, you'll find beneficiary designations on file with the employer that the decedent signed during his or her lifetime. For benefits where the decedent has named no beneficiary, the fallback provision under the employer's plan or the insurance policy typically designates the surviving spouse or the executor of the estate as beneficiary. The employer will need at least one certified copy of the death certificate. Note that not all

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employee benefits have a death benefit (for instance, the decedent may have been collecting pension benefits that ended upon death). The following outline some of the benefits that may apply:

- **Death benefits:** The decedent may have had term life insurance, accidental death insurance, or other death benefits through the employer. Typically, the employer takes care of the paperwork to process those claims, but you often have to provide them with gentle reminders.
- **COBRA benefits for surviving spouse and dependent children:** The decedent may have had certain benefits through an employer, such as health, dental, and/or vision insurance that the surviving spouse or dependent children may be eligible to temporarily continue. Check with the employer to see what, if any, benefits qualify for continuation under COBRA (Consolidated Omnibus Budget Reconciliation Act of 1986).
- **Flexible Spending Accounts (FSAs) and Health Savings Accounts (HSAs):** Some employers provide their employees with a way to pay for out-of-pocket healthcare and/or dependent-care expenses using pretax dollars. Deductions from the employee's salary fund these accounts, (sometimes known as Flexible Spending Accounts [FSAs]), so if the account has a balance at the date of death, that balance can be used to pay for either healthcare or dependent-care expenses incurred prior to death. Check with the employer. And don't forget *HSAs*, savings/investment accounts for pretax dollars the decedent put aside to cover healthcare costs. These accounts, which let you save and invest the unspent money in them from year to year (unlike FSAs, which are use-it-or-lose-it), can transfer to a surviving spouse on death, who can make withdrawals at any time, free of income tax, for healthcare costs.
- **Retirement accounts:** Check for any employer-sponsored retirement accounts. The 401(k) is probably the most common, but you may also find a Savings Incentive Match Plan for Employees (SIMPLE) (look for this plan if the decedent worked for a small company or was self-employed), a Simplified Employee Pension Plan (SEP), a Defined Contribution Profit Sharing Plan (not too common nowadays), and a Defined Contribution Pension Plan (also quite uncommon nowadays).



Figuring out all the places the decedent worked during his or her lifetime isn't easy, but finding and notifying former employers is often worth the effort. Frequently, retirement plans and other benefits are still in place with former employers, who won't find out about the death unless someone (usually you) tells them. Although employers often automatically pay out retirement plans valued at less than $5,000 when employees leave, they're under no obligation to do the same with larger sums, so finding plans in place with old employers that hold tens or even hundreds of thousands of dollars isn't uncommon. To locate former employers, look at W-2s on prior tax returns to which you have access, ask family members of the decedent about any prior employers, and even ask the most recent employer, who may have information about prior employers on file on the decedent's resume. You may also find references to prior employers

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in the decedent's papers. If you're fortunate enough to find a copy of a resume, you've just hit the mother lode!

- **Unpaid salary, bonuses, vacation time, and/or comp time:** Don't forget to ask the employer about unpaid salary, bonuses, vacation time, comp time, and sick time. Some of these may be owed and payable upon death, depending upon the employer's practice. And don't forget reimbursable expenses! Ask if the employee or estate is entitled to anything else. Remember, just because the decedent wasn't around to collect his or her last paycheck doesn't mean that he or she isn't entitled to that income; make sure you collect it!

Locating and Collecting Insurance Proceeds

Many people carry life insurance — your job is to find all the policies and collect the proceeds. Your search of the decedent's papers may have turned up some clues to any insurance on the decedent's life. You may have found the policy itself, records of premiums paid or due, dividend information, or other papers pointing toward a policy.



To collect the policy's proceeds, send a certified copy of the death certificate and a copy of your appointment as executor or administrator to the insurance company. If the company wants the policy itself, which it probably will, be sure that you send it certified mail, return receipt requested, or some other form of delivery service where you'll receive proof that someone at the insurance company received it.

Insurance may come in a couple different forms. Keep an eye open for the following:

- **Traditional life insurance:** Traditional life insurance owned by the insured can be whole life, term, or some other product. Regardless of type, if the policy was *in force* on the date of death (the policy hadn't lapsed through nonpayment of premiums, for example), life insurance pays out an amount specified in the insurance contract to the beneficiary designated by the insured, minus the value of any outstanding loans taken against the cash value in the policy. Note that insurance on the decedent's life that is owned by another person or entity isn't included in the decedent's probate estate or taxable estate.



When searching for life insurance policies, you often need to look in less-than-obvious places. Many people have small policies as a courtesy from their banks or credit unions. Because you're writing to request date-of-death balances for all the decedent's bank accounts, inquire at the same time whether the decedent also had a life insurance policy in force.

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- **Mortgage, credit card, and other loan insurance:** Insurance is available to cover the balance due on a mortgage, credit card, or other loans upon the death of the person. You want to keep your eyes peeled for any reference to such insurance in the decedent's papers, and ask the holders of any mortgages, credit cards, or other loans if any exist.

Ascertaining Any Other Death Benefits

When mining the decedent's personal papers, note any other death benefits you find and contact the appropriate authorities. Be sure to check with any professional, retirement, and union organizations. Start with the following places to determine whether any other death benefits exist:

- **Social Security:** If the decedent has a surviving spouse or minor children who meet certain requirements, the survivors may receive a one-time death benefit of $255 if the decedent worked long enough. To inquire about and collect the benefit, contact your local Social Security office or call their toll free number at 800-772-1213. Dealing with the local office, which is usually quite helpful, is sometimes easier than going through the maze of the telephone system.

  The surviving spouse and any dependents and/or dependent parents may be entitled to monthly survivors' benefits. Apply for these benefits as soon as possible because, in some circumstances, the benefits begin from date of application, not of death.

- **Veterans' Administration:** Eligible veterans, their spouses, and their children are entitled to burial in a national cemetery, a flag, and an inscribed grave marker. Other benefits may also be available. If the decedent was a veteran or the spouse or child of a veteran, you can call the Department of Veterans' Affairs at 800-827-1000 or go to `www.cem.va.gov` for help in determining whether any benefits apply (See Chapter 5 for more details on burial benefits).

- **Individual Retirement Accounts (IRAs):** Even though you probably won't be cashing out any retirement accounts the decedent owned, you need to know what retirement accounts they had, their value on the date of death, and who the beneficiaries are. The decedent may have had IRAs, Roth IRAs, or other self-funded retirement arrangements. After you identify the accounts, a letter from you to the account's trustee (the bank, brokerage, or mutual fund company that holds the assets), together with a copy of the death certificate and your appointment as administrator, executor, or personal representative, should be all you need to obtain that date-of-death value.

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Suing from beyond the grave

If the decedent was involved in an ongoing lawsuit at the time of his or her death, or if a reason to sue arises due to the manner of death, it's the duty of the executor or administrator to continue or pursue the lawsuit. One of us had a case where a surviving spouse didn't want a lawsuit pursued against the driver who caused the death of his spouse. However, the executor was required to pursue the suit to protect the interests of the minor children in the lawsuit and in the estate. And unlike criminal actions, which expire when the defendant dies, civil suits can survive the death of the original parties. One of our grandmothers, who was hit by a car and sued the driver five years before she died, didn't finally collect her judgment until she'd been dead for three years.

Rights of action and claims in tort or in contract (lawsuits) are included on the inventory, and you must determine the status of the suit and pursue it if it survives the decedent's death. The estate's attorney can help the executor to determine whether the cause of action survives.



Choosing how to pay out retirement plans such as IRAs can be a minefield, littered with serious tax consequences to the beneficiary. With traditional IRAs, give a great deal of thought to how the benefits will be paid out, because they may be fully taxable to the beneficiary for income tax purposes. If the beneficiary is a *qualifying individual,* payments can be spread out over the life of the beneficiary, thus tempering the income tax hit. So be sure you don't inadvertently elect a lump-sum distribution! And if the beneficiary is the surviving spouse, he or she can treat the inherited IRA as their own. Check out the latest version of *Taxes For Dummies*, by Eric Tyson, Margaret Atkins Munro, and David Silverman (Wiley), which gives you all the info on what to do, and what not to do, with these IRAs.



Contributions to Roth IRAs were taxed for income tax purposes at the time the decedent made the contributions, so provided that the account was open for at least five years, all withdrawals from it are income tax free. Be sure that you know which kind of IRA you're dealing with, traditional or Roth. This would be a good time to consult with a tax expert with regard to withdrawals because a number of complex issues are at play here.

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Preparing and Filing the Probate Inventory

After you find every asset of the decedent (you hope!) and value it, prepare the inventory required by the probate court. Your local probate court has a form for you to use, and if all your probate assets don't fit on it, just add additional sheets in the same format. Include all the assets subject to probate on the probate inventory including those assets in the decedent's name alone, held as a tenant in common, joint for convenience only, or payable to the estate. Your court probably has a deadline by which the inventory is to be filed, but check to see whether, in practice, it's a hard and fast deadline. You may need the extra time to collect and value the estate assets.

In some jurisdictions it's actually likely to be close to the due date for filing the estate tax return (nine months after date of death), rather than an earlier inventory due date. In some states, the inventory must be filed before you're allowed to sell real estate. Be sure to use the sales price on your inventory; if you're selling for less than inventory value, you may have a problem receiving any necessary license from the probate court. The inventory limits your liability as executor to the values shown on the inventory, if you have used market values as of the decedent's date of death. There is usually an inventory filing fee, payable by the estate.

Liquidating Assets

As the executor or personal representative of an estate, one of your primary responsibilities after you take a complete inventory of the assets is to *liquidate,* or distribute or sell, some or all of them. If the decedent specifically bequeaths or *devises* (leaves a piece of real estate by will) an asset, the executor or administrator can't sell it unless it's necessary to pay debts of the decedent and/or expenses of the estate (see Chapter 8). Among the reasons for liquidating assets before distribution of the *residue* (what's left over after paying all debts, expenses, taxes, and specific bequests and devises) are the following:

- The necessity to raise cash for *pecuniary* (or monetary) bequests, and for debts of the decedent, expenses of estate administration, and taxes
- Ease of division and distribution of the residue
- Fairness (you may not be able to distribute the assets unless they're held in an equitable manner)

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You as executor or personal representative decide what and when to liquidate.



Don't forget that your duty as the executor or administrator is to preserve the assets, not to grow them. If the estate holds stocks and bonds that go down in value, the executor may be accused of not fulfilling his or her fiduciary duty to preserve the assets. And the executor doesn't receive a bonus if the assets increase in value. It can be wise to have a special, or temporary, executor or administrator appointed before the executor is even appointed, for the express purpose of selling stocks and bonds. After assets are liquidated, they can be held in safe investment vehicles such as a bank account or accounts (so that each account is fully FDIC insured), money market funds, and other stable investment vehicles. The following sections discuss what you need to do to liquidate the securities and real estate.

Selling stocks, bonds, and other securities

Most people now hold stocks, bonds, and other securities in brokerage accounts, and gaining access to them so that you can sell them requires that you provide the brokerage with a copy of your appointment as executor, personal representative, or administrator. Check out the two scenarios:

- **If the decedent held all securities in a brokerage firm account which you transferred to the estate's name or if you placed them in a brokerage account in the name of the estate:** Call the broker to sell them.
- **If your decedent still liked to hold onto his or her physical stock and bond certificates:** Your job just became a bit tougher. In order to sell securities held in physical form — if they're in the decedent's name alone — you need the original stock certificates, a certified copy of your appointment as executor or administrator, and a stock assignment form, with your signature guaranteed by a commercial bank.

  If you can't locate the original certificates, get ready for a shock to the wallet, because the cost can be up to $500 per certificate to replace each one lost. You must replace the certificates before you can transfer the stocks. We know of two estates which are still open because the decedents, husband and wife, each had advanced Alzheimer's disease. Their stock certificates are yet to be found, and at $500 per certificate, their executor isn't rushing to replace them.

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Disposing of real estate

If you need (or want) to sell the real estate, the quickest way to assure a sale at the highest price is typically to have the property listed with a reputable broker. If you're not familiar with the area, ask the decedent's relatives or friends, attorney, accountant, or other professionals for recommendations of real estate brokers and then interview the brokers yourself at the property. You want to get a feel for the broker personally, and for his or her brokerage company. Don't necessarily use brokers who offer to list the property for the highest price. They may be doing so just to get the listing, at which point they'll find it necessary to drop the price to make a sale. Instead, go with the broker who has the comparable properties to back up the price he or she proposes and whom you're most comfortable with.



As with any real estate transaction, the executor or administrator must be able to give clear title when selling real estate out of the estate. *Clear title* means there's no question as to the ownership of the real estate and it has no liens upon it.

If the decedent had a will, it may or may not require the executor to obtain the approval of the probate court prior to any sale; if the power to sell isn't specifically stated in the will, you need to get approval of the probate court for the sale if the real estate is held solely in the name of the decedent. Of course, if the decedent had no will, or the powers granted under the will aren't broad enough, the probate court will have to grant a license to sell real estate (or something similar) before the property can be sold and title pass to a new owner. The purchaser or the title insurance company (the company the purchaser pays to guarantee that the title to the property is clear) may also require probate court approval, such as a license to sell, for the sale to proceed. By granting the license to sell or other evidence of court approval (depending on the state the real estate is located in) the probate court is assuring title clear of claims of heirs, and of debts and claims of the estate.



You have a duty to get the highest price for the property; in some states, a license to sell from the court protects the fiduciary by conferring the presumption that the highest sale price was obtained. This step avoids the cumbersome task of putting the real estate at auction or worrying about getting a higher offer after you have agreed on a selling price with a buyer. Thus, as executor, you may want to get a license to sell or its equivalent even if you're not absolutely required to.

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Chapter 8

Paying the Debts, Expenses, Bequests, and Devises from the Estate

In This Chapter

- Identifying the decedent's debts and administration expenses
- Prioritizing and paying debts from estate assets
- Letting beneficiaries know about their right to disclaim
- Segregating and distributing named personal property
- Dividing other personal property equitably and dealing with the rest of the assets

After you set up the estate and have some idea what all the assets are worth (refer to Chapter 7 if you're not sure), you need to start identifying and paying the decedent's debts, the estate's administration expenses, and any claims against the estate. Only after you're sure that you've discovered and paid them all, you can begin distributing the estate's remaining assets to its heirs.

This chapter points out how to determine and pay the debts of the estate and administration expenses, to help a beneficiary to make an effective disclaimer of a bequest or devise, to effectively divide personal and household articles among the decedent's heirs (often the trickiest area to negotiate among those heirs), and to divide and distribute the rest of the decedent's assets.

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Determining and Paying Debts of the Decedent and Administration Expenses

As executor, you should have all the decedent's bills (or be in the process of collecting them; see Chapter 5 for tips on going about this). One of your first tasks is to pay all administration expenses and legitimate debts of the decedent before you make any distributions to beneficiaries. That is, if you have enough assets to do so. In this section, we explain how and when to make these payments.

How and when to pay claims

One of your first duties as executor (after the payment of administration expenses; see the next section) is to pay the debts incurred by the decedent during life. Some types of claims that frequently arise include

- **A lease on the decedent's residence**: Be sure to review the lease, because some may have a provision for termination upon death. In many cases, you can reach an agreement with the landlord for early termination of the lease. In any event, payments under the lease are claims against the estate, but extensions of the lease by the executor while the estate is administered are administration expenses, as are all utility bills for periods of time after the decedent's death.
- **Child support and alimony:** Agreements or court orders to pay alimony and child support are claims against the estate, and you must hold back sufficient funds for future payments.



Here are a few points to keep in mind when you're paying off the decedent's debts:

- **A debt is only considered a claim against the estate if the debt was created before the decedent died.** If it wasn't created before death, it may still be enforceable against the estate as an administration expense; administration expenses are dealt with differently than debts of the decedent. Check out the "Prioritizing payment" section later in this chapter to see how they're different.
- **Before you pay any debts, verify the validity of each claim.** Doing so is a simple matter for most debts, such as utility bills, but you may have to investigate others more thoroughly. For instance, if a relative, friend, or nurse provided care to the decedent with an oral understanding that they would be paid from the proceeds of the estate or left all or a portion of the estate, go directly to an attorney who is expert in probate law.

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Your state's legal precedents can likely help determine whether the claim is valid and can be paid. If actual services were rendered (such as living with and caring for an elderly relative for an extended period of time), the claimant is probably entitled to something from the estate.

- **Check to see whether any life insurance related to the debt (such as life insurance relating to a mortgage) is intended to pay it off upon death.** Also make sure that no agreements are in place that make the indebtedness vanish upon the death of the decedent. An uncle of one of us, for example, bought a new car, complete with a new car payment, shortly before he died. Fortunately, he took the additional insurance offered, which paid off the car loan upon his death.
- **Consider whether the debt is legally enforceable.** Debts such as charitable pledges may only be considered moral obligations.
- **Frequently, your decedent's largest obligations don't need to be paid in full.** Many are secured obligations that stay with the property they're attached to. Mortgages and auto loans, for instance, stay with the property, and whoever inherits the property inherits it with the debt attached.



Keep in mind your state's statutory period within which a creditor must file claims (see Chapter 6 for more). Also, be aware, however, that each state has exceptions to this statute of limitations, including the following:

- Federal claims, including the federal estate tax
- State estate or inheritance tax
- Creditors' liens on property
- Certain governmental and private claims for environmental damage

State statute may also provide that, after a specified time (unless you have notice of claims of a large enough amount for you to be concerned that the estate may not have sufficient funds to cover its debts), you may pay those claims that have been presented to you, and you won't be held liable if funds are needed for later claims. Check with the probate court to see what the requirements are in the decedent's state of domicile.

Prioritizing payment

When the estate doesn't have enough money to pay all the claims against it, don't start paying bills on the basis of the order received or who's screaming loudest for the money. Every state sets its own order of priority; check with a competent attorney or with the probate court to determine in what order you must pay the claims.

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Identifying conditional legacies and devises

The testator and the state can place *conditions* (clauses or laws modifying bequests and devises) on *bequests* (gifts of personal property under a will) or *devises* (gifts of real property under a will). Be on the lookout for the following, and remember, not all conditions created by a testator are recognized as valid, depending upon your state law:

- **The testator:** A decedent will sometimes leave a bequest (or devise with a condition attached). Depending on your state law, some conditions are recognized as valid, and some aren't. For instance, in many states, the condition that the legatee not oppose the will if he or she wants to receive the bequest (known as an *in terrorem* clause) is valid. Conditions that are against public policy are usually found to be invalid. For instance, a bequest to the testator's son, on the condition that he divorce his wife, would be found to be invalid because it's against public policy, and the son could inherit without divorcing. Check with a competent attorney in the field of probate law if your testator placed conditions on any bequests or devises in the will.
- **State law:** Divorce doesn't revoke a will but, in most states, a provision in the will for a spouse from whom the decedent is divorced at the time of his or her death *lapses* (fails to vest in the divorced spouse) unless the decedent has specifically provided in the will that it shall not lapse upon divorce.

The following is a list of the types of claims that typically take priority:

- Reasonable administration expenses, including attorney and other professional fees
- Funeral expenses and the expenses of last illness
- Federal and state taxes
- Medicaid claims

Generally, you can only pay all other claims after you've paid all these claims in full.

Declaring the estate insolvent



When you have more claims against the estate than assets to pay them, you must declare the estate *insolvent*. Before taking this step, consult with a probate attorney who has experience with insolvent estates in your jurisdiction. You're going to need his or her guidance to know the procedure for declaring insolvency in your state and figure out what you're allowed to pay.

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If the decedent had a funded revocable living trust, you can usually (depending on what state he or she lived in) use it to satisfy creditor's claims. Hopefully, a decedent who funded a living trust made provisions in it for the payment of debts and expenses of administration by the trustees; that way, an insolvent estate doesn't have to go through the courts to access the trust fund.

Informing Potential Beneficiaries of Right to Consider Disclaimer

Under both transfer tax law, including estate, gift, and generation-skipping (see Chapter 17), and state probate law, a beneficiary may elect to *disclaim*, or refuse, an interest in property he or she doesn't want to accept. Why on earth would anyone choose not to inherit, you ask, unless he or she has taken a vow of poverty? As with many decisions in a person's financial life, the answer is "for tax reasons." When someone effectively disclaims an interest in property, he or she is refusing it before receiving it.



As the estate's executor, it's your responsibility to inform the beneficiaries that they have the option to disclaim any or all of their legacy. In practice, if you have a feel for any or all of the beneficiaries' financial situations, you'll know whom to approach with this information — that would be the beneficiaries who already may have taxable estates for federal estate tax purposes (see Chapter 16 for the current taxable estate levels). For purposes of inheritance (including federal and state gift and estate or inheritance tax purposes), a disclaiming beneficiary is treated as though he or she predeceased the decedent. The assets disclaimed then pass to whoever is next in line to receive them. You may know the respective beneficiaries' financial situations (probably because they're descendants of the decedent, who shared their financial situations with you during life); otherwise, you can just present this option to each appropriate beneficiary as a possibility.

Consult your state's law for specifics, but generally speaking, to *make an effective disclaimer* (refuse the inheritance) the disclaimant must

- Refuse the property, in writing, within a reasonable time after becoming aware of it. Check state statutes, but *reasonable time* is often nine months, which is the same as the deadline to file **Form 706** without extensions.
- Accept no benefits from the property.
- Have no control over who receives the disclaimed property.

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Knowing about pretermitted heirs

A child or issue of a deceased child who isn't provided for in the decedent's will, known as a *pretermitted heir*, is entitled to the share he or she would have received if the decedent had died without a will (*intestate*). However, the pretermitted heir isn't entitled to anything if the decedent has

- Provided for that child or issue during life, or
- Made it clear, usually in the will, that the omission was intentional.

Check the fine points of your state law if this situation arises.

Testators who really want to disinherit an heir are very canny about crossing their *t*'s and dotting their *i*'s, and will likely have included a specific clause in their last will either saying that no provision has been made for that beneficiary under the will because he or she was provided for during lifetime or leaving that beneficiary some token amount, like $1 or $100.

Disclaimers can be very helpful in correcting overfunding or underfunding of marital deductions, or simply in not growing the disclaimant's taxable estate unnecessarily if he or she is content with the new recipients of the disclaimed property.

So, for instance, if a beneficiary's descendants stand to inherit the beneficiary's share if he or she predeceases your decedent, an effective disclaimer will pass the assets to that next generation at no estate or inheritance tax cost to the disclaimant. Of course, the estate will have a transfer subject to generation-skipping transfer (GST) tax in that illustration, which you as executor must keep in mind in preparing the **United States Estate (and Generation-Skipping Transfer) Tax Return (Form 706)**. See Chapters 16 and 17, and consult a competent estate and GST tax expert.

Segregating and Distributing Specific Property

As the estate's administrator, you're responsible for securing all assets, including personal and household property. If a decedent *bequeaths* (leaves in his or her will) any specific items to a beneficiary or beneficiaries, you're responsible for separating and segregating those items.

If you don't take the necessary precautions (such as locking them away out of the reach of light-fingered relatives) to protect the assets, you'll be in a pretty pickle if, when the time comes for distribution, you can't come up with Aunt Hattie's engagement ring or Cousin Minerva's pearls. These are exactly the kinds of items that can come up missing when family and friends with a feeling of entitlement have unsupervised access to the residence of the decedent.

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This section takes a closer look at specific scenarios you may encounter when segregating and distributing the different types of property and what you must do to ensure that the beneficiaries receive what's due to them.

Tread slowly before distributing

When securing the decedent's assets before you actually distribute anything to beneficiaries, you want to ensure that you tread carefully. Take your time and carefully refer to the will and its instructions before making any distributions. Keep the following in mind before you release anything:

- If the property named in a specific bequest or devise is no longer owned by the decedent at death, that bequest or devise has no effect and is considered *adeemed.* The legatee receives nothing, unless state law provides otherwise. For instance, if the decedent left a particular bank account to a beneficiary under the will and the bank account no longer exists, the beneficiary receives nothing.
- If a named beneficiary of a specific bequest or devise died before the decedent and the will makes no provision that the beneficiary's heirs or another person inherits, the bequest or devise fails or *lapses*, unless state law provides otherwise. Massachusetts law, for example, provides that if the named beneficiary who predeceased the decedent is a child or other relation of the decedent, that beneficiary's issue, if any, inherit unless the will provides otherwise.
- If the decedent left a will, check to see whether it contains a clause saying that all debts, expenses and taxes are to be paid from the *residue* (the amount left after paying out all specific bequests and devises) of the estate. Be sure to also review any revocable living trust for similar language regarding paying expenses of the estate.
- If the decedent's state of domicile has an inheritance tax, be sure that the tax isn't attributed to the legatee or devisee and payable by them or from what they inherit from the estate. If the beneficiary is liable for the tax, you want to pay it from their share or have proof they've paid it before distributing their bequest or devise, unless the will provides that the estate pay such tax.



Making the distributions

As you distribute each asset, follow these important general steps:

1. **Have the recipient date and sign a receipt for the property.**

   Have a receipt already prepared, describing the property you're distributing and, in the document, having the beneficiary acknowledge receipt of it.

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2. **If the distribution completely fulfills the bequest or devise to that beneficiary, obtain the beneficiary's signature on an assent to the allowance of your accounts as executor.**

   That way, when it's time for you to have the probate accounts allowed, you don't have to track down the beneficiary. The receipt and assent will be filed with the probate court when you have your estate account(s) allowed (and, of course, remember to keep copies for your estate records). See Chapter 9 for more on account allowance procedures.

The following sections focus on the specific types of property and any unique requirements you have to do when distributing them.

Consider tangible property

Tangible property is property you can touch or feel, such as a chair, a handkerchief, or a piece of land. Tangible property can be divided into two classifications: tangible personal property and tangible real property. Knowing these two classifications is important because, in your role as executor, these terms come up frequently and it's helpful to know what property the court (or whomever) may be referring to. Also, tangible real property (real estate) is always handled differently than other estate assets. How it's handled depends on the law in your decedent's state.

- **Personal property (*bequests* — gifts under the will of personal property):** If the decedent left specific bequests of personal property, you may distribute those bequests only after you've been appointed as executor, the property has been appraised, the date for filing of claims has passed, you've made sure that you have adequate funds to pay all estate expenses, and you've checked the estate and income tax consequences described earlier in this chapter.
- **Real estate (*devises* — gifts under the will of real property):** In some states, title to real estate passes automatically to the heirs upon the decedent's death, subject to any mortgage or lien on the property and to payment of debts of the decedent (including any estate taxes owed). You need take no formal action. In many other states, real estate held in the decedent's name alone appears on the estate inventory and must pass through probate in the same manner as any other probate property. In some states, to distribute specifically devised real property, you specifically petition the court for approval of distribution of the real property and obtain a court order allowing the distribution and including the property description. The resulting court order is then recorded with the register of deeds in the county where the property is located to show the chain of title passing to the beneficiary. Check with your local probate register to determine the method of transfer in your state.

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Look at intangible property

Intangible property is property that has no value in and of itself but is the evidence of value, such as a stock certificate or bond. You can distribute intangibles at the same time and in the same manner as tangibles, except that, unless they're *bearer bonds* (which aren't held in any name), you may have to go through a process to reregister them in the beneficiary's name.

To have stocks and bonds reregistered in a beneficiary's name, either send or take the following for each such security either to the transfer agent directly for each security (the transfer agent will be shown on the face of the security), or take all securities to a bank or brokerage firm (each of whom will likely charge for this service):

- The bond or stock certificate.
- A form entitled "Assignment Separate from Certificate" with your signature guaranteed (you can obtain this form from the bank or brokerage house if necessary, and they can also guarantee your signature). If you have a bank or brokerage firm with which you have a friendly relationship, one of their employees who is qualified to do so may be willing to guarantee your signature at no cost.
- A certified copy of your Letters of Authority as Executor (the certification by the court needs to be less than 60 days old). You obtain this document from the court for a small fee.
- Depending on the transfer agent and your decedent's state of domicile, you may also need an affidavit of domicile, a waiver of state taxes (from your state taxing authority), and certified copies of the decedent's death certificate and will.

If you're holding the security in an estate brokerage account, you distribute to the beneficiaries by instructing your broker, in writing, of the names in which the securities should now be registered. Of course, in establishing the estate brokerage account, you've gone through similar transfers for each security, although the broker will have handled the paperwork.



If you're actually reregistering physical stock and bond certificates, the new certificates in the beneficiary's name should be returned to you. Make everything as easy as possible for the beneficiary to comply with. Send the new certificates to the beneficiary, certified mail, return receipt requested, along with a receipt for the beneficiary to sign and return in the postage paid return address envelope that you enclose.

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Bequest of specific dollar amount

To fulfill a bequest of a specific dollar amount called a *pecuniary bequest,* simply write a check on the estate's checking account (making sure that you have transferred funds to the account for this purpose) at the appropriate time, which is the same as for tangible personal property and, of course, obtain the necessary receipt.

For example, if the decedent left a bequest to her nephew of $10,000, after the period for filing of claims against the estate has passed, if it's clear there's plenty of money to pay all taxes, debts, and expenses, you may write a check to the nephew from the estate's checking account in the amount of $10,000, and mail it to him, certified mail, return receipt requested, along with a receipt for him to sign for the bequest and an assent by him to the accounts of the executor.

Dividing Other Personal Property Equitably

Divvying and dividing the personal and household articles is frequently one of the stickiest parts of estate administration. Whether the estate is large or small, we've both witnessed many times the passion heirs can feel toward the personal property of the decedent (and toward the other heir who gets something they wanted). Unfortunately, sometimes figuring out how to divide up the property isn't so crystal clear. This situation arises under the following conditions:

- The decedent leaves all *personalty* (person and household items) to a class of beneficiaries, such as "those of my children who survive me"
- The personalty falls into the *residue* (the assets left after payment of all debts, administration expenses, and bequests and devises) for lack of a specific bequest, and the residue goes to a class or group of people
- The decedent dies *intestate* (without a will) and a group, such as the decedent's children and the issue of any deceased child, *per stirpes* (by right of representation, that is, the children of such deceased child, and if any of those children is deceased, that deceased child's children, and so on) inherit

None of these three conditions are completely black and white. In each of them, no plan is available for distributing the personal articles. You can always hope the decedent at least left labels or stickers on the bottom of furniture, but stickers can dry up and fall off (or get switched; perish the thought). Following we discuss ways to deal with this unfortunate and messy situation.

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Basing division on letter of intent

The best of all possible worlds is when the decedent has left a *letter of intent* written during his or her lifetime, where he or she listed which items of property are to go to whom. This letter may even be referred to in the will. Such a letter takes the burden of division off you as executor and, although the beneficiaries may still harbor hard feelings, they have only the decedent to blame (not each other). Although this letter doesn't have the legal standing of a will and shouldn't be used in place of one, it's very effective at silencing family bickering and beneficiaries' claims that Mother always intended for them to have the family silver.

All you have to do is follow the decedent's clear wishes in the letter of intent and distribute the respective assets to the designated persons. ***Remember:*** Don't forget to get receipts listing each item received and assents to the accounts.

Creating a system for heirs to choose

If you're left no guidance by the decedent, such as a letter of intent, you must create an equitable system for the beneficiaries to choose the items they want to have. So how do you do that, you're wondering? One method is to draw the names from a hat (or whatever vessel you have handy) to establish the order in which they may choose. Each person then takes a turn choosing one item, perhaps applying color-coded stickers as they do so, until all items of interest are accounted for. Don't be surprised if this process goes down to the last pie plate. Again, getting a receipt listing each item received by a particular beneficiary is crucial.

Disposing of unwanted personal property

As you're distributing the personal property, you may come across some items that no beneficiary really wants. If that's the case, you have several options. If you have enough items to attract an auctioneer, you can hold an auction, with the proceeds divided among the beneficiaries. Or you can donate the unwanted personal property to any charity that takes such property. In fact, many charities make house calls if you have large items or specific items they're interested in. Just be sure to get a receipt if you're thinking of taking that tax deduction, if it's allowed.

If the will directs you to give the personal property to charity, you can deduct the amount of the gift on **Form 1041, Schedule A,** which is located on the back of the form. Do an Internet search of the local area or check the phone book if you aren't familiar with any such charities.

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Slicing Up the Residue

The *residue* of the estate represents all assets left in the estate after payment of all debts, administration expenses, and taxes and the distribution of all specific bequests and devises. Your job here is pretty clear cut: Either your decedent made provision for the disposition of the estate's residue in his or her will or the state laws of intestacy provide for the manner of distribution. (See Appendix B for brief summaries of individual state laws.) If your decedent left a will that leaves the residue to his or her revocable trust, the residue simply *pours over* into that trust, and you merely bring about the transfer of the assets into the trustee or trustees' names in whatever manner those trustees direct (for instance, into a brokerage account in their names).



To fulfill a bequest of a specific dollar amount, simply write a check on the estate's checking account (after making sure that you've placed sufficient funds there to do so). You may pay the bequest after the period for filing of claims, as we discuss earlier in this chapter.

The following list briefly touches on the main two ways to handle the rest of the pie and distribute the residue:

- **Dividing up the residue by percentage or fractional share:** If the residue is to go to more than one person or entity, the will may provide that the residue be divided by percentage or fractional share of the total assets. Each will have the same effect. For instance, it may say, "25 percent to each of my four children who are then living, per stirpes," or, "¼ to each of my four children who are then living, per stirpes." In each case, one-quarter of each asset is distributed to the then-living children and the issue of each deceased child. (In this example, the will would hopefully make provision for the contingency of a child dying leaving no issue, typically that that share would be divided among the other children's shares).
- **Dividing by per capita or per stirpes:** If the residue is to be divided *per capita*, each person gets an equal share, no matter what the relationship to the decedent. If the residue is to be divided per stirpes or by right of representation, you divide it equally at each generational level, with any issue of a deceased person to take his or her share. For instance, the residue may go to all the decedent's children living at the decedent's death, with the issue of any deceased child to divide that child's share equally per stirpes.

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Chapter 9

Closing the Estate

In This Chapter

- Getting the necessary documentation to close the estate
- Taking care of the last administrative expenses
- Doling out the rest of the distributions
- Preparing and filing the final paperwork

Administering the estate has been a long haul, but the finish line is within easy reach now. If you're ready to close the estate, you just need to make sure you wrap up all loose ends. Closing the estate may seem like a lot of work, but trust us: Compared to what you've already accomplished, this final step is a cakewalk.

In this chapter, you reach the culmination of your hard work, dedication, and attention to myriad details on behalf of your decedent. Here's where you find everything you need to do as executor to wind up the estate and just how to do it: getting releases of lien for real estate, paying final administration costs, making final distributions to residuary beneficiaries, preparing probate accounts and getting them approved by the court, preparing final income tax returns, obtaining tax closing letters, and filing with the probate court all those receipts you collected from the beneficiaries.

Obtaining Tax Closing Letters

If you filed a Form 706 (United States Estate [and Generation-Skipping Transfer) Tax Return; see Chapters 16 and 17], and/or a state estate or inheritance tax return, you need estate *tax closing letters* (letters saying the IRS and the state have accepted the returns, as filed or with adjustments) before you can close the estate. At this point, you pay any added taxes caused by adjustments; if you're lucky enough to avoid those, you may even get a refund (although that's unlikely).

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The following are the two types of tax closing letters you'll receive:

- **From the IRS:** The IRS issues an estate tax closing letter when it concludes that the return is accepted as filed or that the required adjustments are completed. You can then proceed to close the estate.
- **From the individual state(s):** After you've received your federal estate tax closing letter, file it with your state tax authority, including any information on adjustments made to the estate tax return as filed. (You may have a deadline on this filing, so be aware). The state taxing authority then issues its closing letter, making any adjustments based on the federal return.



Don't put the federal estate tax closing letter in the pile of things to get to when you have a chance. File it promptly in any states where you've also filed an estate or inheritance tax return or paid any estate taxes (check out Appendix B for a list of states that currently charge taxes on estates or inheritances). Remember, you can't put this task of estate administration behind you until you finish all these seemingly minor — but actually fairly important — details.

Obtaining Releases of Lien for Real Estate

Whenever someone dies, the title to any real estate he or she owned (whether alone or with someone else) gains a little cloud, an estate (or inheritance) tax *lien,* that prevents you from selling the property with a clear title until you (the executor) have taken care of it. Liens are how states and the federal government make sure they receive the taxes they feel are due, and you can only release the lien if you pay those taxes or prove to the taxing authority that no taxes are due. To obtain a federal estate tax release of lien, request that a **Form 792, Certificate of Release of Lien**, be issued when filing your **Form 706** (see Chapter 16).

Check with your state's department of taxation to see what steps you need to take to release the state's lien. Liens should be released prior to the sale of the property, but that's not always possible. Don't fear if some taxes are due but you don't have the money to pay them; the state sends someone to the closing to collect the taxes owed in exchange for a release of lien. If there's some question whether or not taxes are due, the state often accepts an escrow payment, which it refunds after a final tax determination has been reached.



If there's no taxable estate for federal estate tax purposes, you can't get a release of lien, but that's okay. Instead, have your real estate or estate attorney prepare a recordable affidavit stating that no estate tax is due, and sign it in your capacity as executor, administrator, or trustee, whichever applies.

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After you have the release of lien or affidavit in your hot little hands, run, don't walk, to the Registry of Deeds in the county or town where the property is located to record that baby. The release of lien or affidavit becomes part of the title history attached to that property, and every time it's sold or refinanced, that lien and its subsequent release or the affidavit will be noted on the title examiner's report. Check with your local probate court, register of deeds, or a local probate attorney to see which method is used in your state to obtain clear title on the real estate.

Paying Final Administration Expenses

When you're close to finishing and closing an estate, making final distributions to residuary beneficiaries before you pay amounts still owed for administration can be tempting. Be patient and make sure that all administration expenses are paid first; otherwise, you may find yourself begging, usually unsuccessfully, for the residuary beneficiaries to give back some of what they've received so you can pay what's still owed. The following are fees that are typically still owed as you come toward the end of the estate's administration:

- **Attorney's and accountant's fees:** For preparation of Form 706 and Form 1041, and for the probate accounting.
- **Executor's or administrator's fee:** Pay yourself your executor's fee, which must be reasonable. You establish your fee in one of two ways: The decedent's will determines the amount (or at least spells out how to calculate it), or state statute fixes the amount based on a fee schedule. In some jurisdictions, your fee as executor must be what would be considered *reasonably necessary.* Some of the factors that may be considered in determining your fee include
  - The size of the estate
  - The complexity of estate matters that you're called upon to handle
  - The amount of time you spent administering the estate
  - How well you did your job
  - Fees received by others for similar work
  - The results of your efforts

  You're also allowed reimbursement for reasonable expenses you incurred in administering the estate, from appraiser's fees you paid out of pocket to the cost of envelopes and postage.

  Be sure to itemize all such expenses in your accounting so the court can see where the money has gone.



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- **Miscellaneous administration expenses:** Pay any other unpaid expenses of administration, including to other professionals and the court, or set aside funds for their payment. Any funds set aside, which should be minimal at this point, should be kept in a non-interest bearing account to avoid having to recalculate the estate income tax for very small earnings or file another year's return to satisfy the IRS.
- **Estate income taxes:** Although owing any estate income taxes on the final returns is uncommon, make sure that you pay anything you do owe.

Here's where your up-to-date checkbook and accounting records come in handy. Check them to see what fees are outstanding. Check out Chapter 8 for more info on paying these different expenses.

Making Final Distributions to Residuary Beneficiaries

Although you can make partial distributions of *residuary* (what's left after payment of expenses, debts, taxes, and specific bequests and devises) shares after the period for filing claims has passed and you know the amount of the estate and inheritance taxes, such partial distribution is by no means required. However, in order to completely close the estate, you should make final distributions of residuary shares when you've settled all the affairs of the estate, including receiving the estate and inheritance tax closing letters, and prepared the final account (and, in some circumstances, not until after its allowance by the probate court). If you haven't paid all the final expenses, keep a reserve to do so. (Refer to Chapter 8 for the lowdown on how to make distributions to residuary beneficiaries.)

Preparing and Filing Final Estate Income Tax Returns

After you distribute all the estate assets, you may now prepare the final estate income tax returns even if you haven't reached the end of your tax year. Because no tax is due, you're not in any danger of paying taxes before you have to; you're only making sure that you don't forget this important step. Write the dates of the tax year you're using at the top of the form, and be sure to mark this return "Final" by not only checking the box but also writing the word *Final* across the top of page one in black or red marker. Trust us, this part feels terrific! Chapter 19 discusses specifically what happens to the estate income and deductions for tax purposes in the final year of the estate.

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Check out Chapter 18 for a thorough discussion of how to prepare the estate income tax returns. You've no doubt been preparing and filing these right along on a yearly basis and in a timely fashion, even if you haven't done much other accounting work until now, because Uncle Sam waits for no man, woman, or executor.

Preparing Accounts for Allowance by the Probate Court

You may feel that we've overemphasized the importance of keeping good records, but good records really come into play now when you're closing the estate and preparing the estate accountings for *allowance* (approval by the probate court). Those records you've kept will pay off in spades.



The exact procedure and order of events for allowance of accounts and for closing your estate varies by your decedent's state (and even county) of *domicile* (decedent's legal residence). In some states, the final account is first presented for allowance, and after it's allowed, the court enters an Order Assigning Residue. You distribute the assets to the beneficiaries and obtain receipts. The final step is to file the receipts with the probate court and prepare and request that the court enter a Discharge and Order Closing Estate. Be sure to check with your local probate court for the proper procedure and order of these events; you've come so far, it would be a shame to mess up now. This section helps you prepare your accounts and petition for allowance, distribute the balance of the estate (the *residue*) to the beneficiaries, and obtain your discharge as executor.

Use the appropriate form of accounting

Prepare your probate accountings based on the accounting form used in your local probate court. You may prepare your accountings on an annual basis as you do your estate income tax returns (and, in fact, some courts may require that you do so and file them annually with the probate court). Check to see what form of account applies in your jurisdiction and when they are required to be filed and allowed. Even if they're required to be filed annually, you may not be required to seek their allowance until the final account is filed. The first (which is sometimes also the final) accounting starts with the assets you listed on the estate inventory.

Check with your court to see which one of the following forms of probate accounting you should use.

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Principal and income

Some states require an accounting that differentiates between income and principal, but most don't for estates (but may for trusts under wills). *Income* is interest, dividends, rents, and the like; the earnings on the principal during the period of the accounting. *Principal* is the assets of the estate on which income is earned. *Principal and income accounting* basically means that the principal and any additions to or subtractions from principal are accounted for on their own schedule (or in a separate column depending on the form the court is using), and income to the estate is accounted for on its own schedule (or in its own column of the accounting). The income and principal are then reconciled at the end of the accounting or at the bottom of the columns. Check out Chapter 12 for more on the differences between these two terms and a sample account.

Receipts and expenditures

In some states you have to report assets or income received (*receipts*) on one schedule, including as your first entries those assets on the probate inventory (for example, Schedule A), expenditures on another schedule (for example, Schedule B), and property on hand at the end of the accounting period on a third (for example, Schedule C). This form of accounting is called *receipts and expenditures accounting.* If your accounting balances (as it should), and this is your final account, your ending balance will be zero because you'll have distributed all the assets of the estate before you file your final accounting.

Length of accounting period

Some courts may require that an annual accounting be filed, but others permit your accounting to run from the date of death through the closing of the estate, even if that period is several years. If you're preparing an annual account, you may have two choices to bring your account to a full year after your decedent's date of death:

- Using a calendar year-end (which coincides with those 1099's you may be receiving)
- Using a *fiscal year-end* (any month end other than December)

If your court allows a choice, choose whatever works best for you. Remember, just because you may have chosen a fiscal year-end for income tax purposes doesn't mean you're required to choose the same year-end for your probate accounting. (Refer to Chapter 18 for more info on deciding which choice may be right for you.)

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Obtain assents of beneficiaries

In the best of all worlds, you next obtain the *assent* (a form of written agreement to the account) of each interested party to the probate account. The court then typically *allows* (approves) the account on the basis of those assents without *notice* (giving notice to each interested party in a manner set forth by the court, similar to the notice requirement for allowance of the will in Chapter 6), which saves you the time and expense of service of a *citation* (check out the following section).

When you obtain a receipt from a beneficiary for distribution (which we discuss in Chapter 8), you hopefully also obtained an assent to all of your accounts as executor if the distribution fully satisfied the interest of that beneficiary under the will. For those assents you didn't obtain, now's the time to send to each beneficiary the following:

- A copy of the account(s).
- An assent form (which you can obtain from your probate court), sometimes called an Assent and Waiver of Notice, for the beneficiary to sign, indicating that he or she assents to the probate court's allowance of your account(s) and requesting that the court allow the account(s) and (in certain instances) waive receipt of notice that the account is being presented to the court for allowance. (***Translation:*** The beneficiary doesn't want an official notification that the account is being presented.)



Be sure to include an extra copy of the assent form for the beneficiary to keep, and a self-addressed, stamped envelope, if you want a prompt reply from your beneficiary.

Get the probate court's approval without all assents

Before you can close the estate, you need to jump through a series of hoops to have your accounts *allowed* (approved) by the probate court. Doing so may take time, but getting the probate court to approve your actions as executor is well worth it in the end, because you're then generally relieved of liability (except in the case of fraud or manifest error). Check with your local probate court for the exact procedure for allowance of accounts. In the final stages before you can close the estate, there are some common requirements.

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Time for filing

Although some jurisdictions allow you to file accounts that cover more than one year, others require you to file an account annually with the court, whether or not you seek its allowance by the court. Often, you don't file any of the accounts until the estate is closed and you seek their allowance by the court.



Be aware, though, that certain states put more emphasis on timely filed accounts than others, and you may be liable for late fees or even court sanctions if you don't produce the required accounts when they're due. Even if you're living in a state with a laissez-faire attitude toward most accounts, the more contentious your dealings with any or all of the interested parties, the more likely your probate court is to demand that you produce the accounts according to its deadline. Always check with your local probate court for its policy on the time for filing accounts and its enforcement of that policy.

Filing fees

Most if not all states have a filing fee, set by statute, that must accompany the filing of the account with the probate court. In order to file the account, you need to make that sure you pay these fees. The amount of the fee may be based on either the size of the estate or the length of account (so much per year, if you have a multiple-year accounting) and is intended to cover the cost of the probate court's review of the account. Check with your local court before filing your accounts because the fees are subject to change.

Petition for allowance

Prepare and file a petition for allowance of the account, and also prepare a proposed order allowing the account. In the petition, you ask that the account(s) in question be allowed, your actions as executor be approved, and anything else pertinent to the particular account, such as your executor's fee and distribution of the residuary estate, be allowed. File these and the account with the probate court along with the receipts of the beneficiaries (see the next section). At this time, request that a citation be issued, unless you have assents of all interested parties.

Receipts of specific and residuary beneficiaries

With the accounting, file all the receipts (forms where the beneficiaries acknowledged receiving their bequests or devises) from the specific (beneficiaries of specific items or amounts) and residuary (beneficiaries who received the residue) beneficiaries with the court. See Chapter 8 for a discussion of specific and residuary bequests.

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Citation

During the process of closing the estate, you also need to deliver a citation, which may have another name and slightly different format in your decedent's jurisdiction; check with your local probate court. A *citation* is a notice sent to the interested parties in the manner specified by the court, either by publication or mailing. The citation includes a return date, typically four to six weeks later, set to allow time for the interested parties to have received the citation by regular mail and to respond to it if they so choose. The *order of notice* accompanying the citation indicates how far in advance of the return date you must mail or deliver a copy of the citation to the interested parties.

You obtain the order of notice from the probate court and pay a small fee. At the bottom of the citation, you complete the return of service, where you indicate what method of service you used, sign and date it, and return it to the court by the return day. You must carefully determine the interested parties who must receive the citation. The following are the usual interested parties, but check with your local probate court that you've correctly identified your interested parties:

- The beneficiaries, heirs-at-law, or their guardians (as applicable).
- If your residuary beneficiary is the trustee of the decedent's revocable trust, as is common in estates including revocable trusts, the trustee (but not the trust beneficiaries) is an interested party.
- If one of the beneficiaries is a public charity, you must give notice to the Attorney General in the decedent's state of residence.
- If a beneficiary is mentally retarded, you must give notice to the department of mental retardation in the beneficiary's state of residence.



Check to see whether your state requires a specific type of mail. In Massachusetts, for example, the statute requires you to send the citation by registered mail, which has been further defined to include certified mail. Be sure to request a return receipt. Make notations in your file of the day you mailed the citation and attach your return receipts to this notation when you receive them.

You may also be required to publish the citation in a local newspaper acceptable to the probate court unless all interested persons receive actual notice. Unless you've been able to hand deliver notices to all interested parties, you need to publish. The court can give you information on which newspapers meet the requirements necessary for legal notices. And, of course, the cost of publishing the citation is an estate expense.

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Be sure to retain copies of the newspaper pages where you've had the citation published. Because you're paying for the legal notice, the newspaper will most likely provide you with one tear sheet showing the ad, the date it was published, and the name of the publication. Don't hesitate to ask for extras at the time you place the ad; the paper will be happy to provide you with them at the time the paper's printed, but many of these papers don't keep a large number of extra copies hanging about after the fact. If you ask a week or two after your legal notice has appeared, you may be out of luck.

Guardian ad litem

A *guardian ad litem* (GAL) must be appointed under certain circumstances to represent the interests of persons not yet born or ascertained (such as when the residuary beneficiary is a trust under the will for the decedent's descendants, and the executor is also the trustee), or legally incompetent (such as a minor with no legal guardian). Seek advice from an attorney experienced in probate law if you're uncertain whether you need a guardian ad litem. If a GAL is required and appointed by the court, you give service of notice to the GAL and provide them with a copy of the account and ask that they assent to it. You then file a form from the GAL assenting to the account, along with the return of service on the citation and the military affidavit (see the next section), with the probate court on the return day.

Military affidavit

In some states, before you can close the estate, you need to file a military affidavit stating whether any beneficiary is in the military service. You must file it whether or not a beneficiary is in the military. If so, an assent must be obtained from that person or a military attorney appointed to represent them. The same person can act as military attorney and guardian ad litem.

Entry of judgment allowing account

If all is in order when the account is filed and no one objects to its allowance, the court may enter a judgment allowing the account no earlier than the day after the return day. Some courts prepare the judgment, and some require that you prepare a proposed judgment for the court. Check with the court to see whether you're preparing the judgment. If it wants you to do so, ask the court for a sample form of judgment if you haven't prepared one in the past. Who prepares the judgment varies by not just state, but by county.

Surety

When the accounts have been allowed, notify the *surety* (the company guaranteeing the bond, to whom the estate has paid a fee, unless the bond was allowed with personal sureties, such as attorneys known to the court) on the bond (see Chapter 6) as applicable. The surety will then stop billing the estate for its services.

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Part III

Operating a Revocable or Irrevocable Trust



"As Trustee, I've been empowered by the Trust to manage the funds, disburse the assets, and do this."

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In this part . . .

You may have dreamed about the day someone would hand you a large sum of money and tell you that you were now in charge. Well, that's not exactly what happens when you become the trustee of a funded trust, but that situation has some similarities — and lots of differences. When you're a trustee, you're bound by lots of rules governing what you may and may not do with the property in the trust.

How do you know what you are and aren't allowed to do with trust property? Whom can you make distributions to, and how much? How do you account for the property, and how should you invest it? You find all these answers in this part. We even tell you what records you need to keep and how to terminate the trust after it has run its course.

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Chapter 10

Understanding the Trustee's Duties

In This Chapter

- Making sure that you understand the trust instrument
- Using your discretion to fulfill the grantor's wishes
- Keeping an eye on the assets and their best uses
- Staying on top of the paperwork

After you've been named, and agreed to serve, as *trustee* (a person who holds property for the benefit of another) of a *trust* (a right of property that one person holds for the benefit of another; the conditions of the trust are usually spelled out in a *trust instrument*), you need to understand the trustee's duties and powers as soon as possible. Your duties may vary based on the type of trustee you are (independent or family), but regardless, you now have fiduciary duties! Hopefully, the trust creator asked whether you were willing to serve before he or she named you as a trustee.

Whether or not you were asked beforehand, you don't actually become a trustee until you accept the position; you can always decline to serve. Assuming you've agreed to serve, go over that trust instrument with a fine-toothed comb and ask the grantor's attorney (or one of your choosing) for the answers to any questions you have regarding the document itself or your role as trustee. This is no time to be shy; as with the rest of life, ignorance of the law is no excuse.

This chapter covers the role you've assumed, the duties you'll be expected to carry out, and the expectations others will have for you. Read on, and enjoy the confidence the grantor has expressed in you!

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Reading the Trust Instrument

The trust instrument is your new bible, and reading and understanding its intentions is the first step in identifying your duties and powers as trustee. In the trust instrument the trust's *grantor* (creator) includes all the powers he or she wants you to have and may specify some you can't have! The laws of the state the grantor chooses to govern the trust address any issues you can't find an answer for in the trust instrument; that state's laws also trump the trust instrument if it goes against them. With respect to the validity of a trust, the grantor must choose a state's laws with some connection to the trust. The grantor has the option of choosing either the *domicile* (residence) of the grantor, a trustee, a beneficiary, or even the location of trust assets; whichever state's laws the grantor chooses govern all aspects of the trust. For real property held in the trust, the laws of the state in which the property's located govern that property. After you read the trust instrument, you'll also know what the grantor's plans are for the trust over time and for the people included in it as beneficiaries.



Of course, if you know about the trust before you actually assume any power over the property and are on close enough terms with the grantor, it's always a good idea to talk with the grantor about his or her hopes and dreams for the property and exactly what benefit he or she wants the beneficiary to derive from the trust. Many trust instruments are couched in such nonspecific language as to allow the trustee the widest possible latitude, but the grantor's actual intent may be much more specific. One of us, for example, has been named trustee for a trust set up to look after the grantor's sister and friend. Although the terms are intentionally vague, conversations with the grantor have made it clear what his intent is; now the job of the trustee is to carry that out to the best of her ability.

This section helps you take the trust instrument and develop a plan to execute it. Furthermore, we explain all the individuals who may play a role in a trust.

Creating a plan based on the trust's terms

The terms of the trust govern what happens to the trust assets: who takes care of them (the trustee), who benefits from them (the beneficiaries), and how they will be invested. The terms of the trust instrument also dictate whether the property funding the trust remains in a single trust or is divided into multiple trusts governed by the same instrument. If the grantor wants multiple trusts, the instrument also directs when to divide the assets and when and how to make payments to beneficiaries. You as trustee make your plan for caring for the trust assets and beneficiaries based on what the trust instrument tells you to do and when to do it.

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For example, say you're trustee of the Abigail Jones Trust, which is receiving assets from the Abigail Jones Estate. Under the terms of Abby's trust, you divide the property you receive upon her death equally into three trusts, one for each of her children, with the trusts lasting for their lifetimes. As trustee, you have broad discretion under the trust instrument to pay or accumulate income and principal from each trust. Abby's eldest child is a spendthrift; money runs through his hands like water. You know you'll need to be parsimonious in making distributions to him, so you place a fair amount of the assets in long-term growth investments. Abby's middle child is a young schoolteacher. She'll never make a large salary, but she lives within her means. However, she'll have a hard time accumulating a down payment for a home, which you know was a priority of Abby's. So you place a portion of the assets in her trust in a fairly liquid investment, for the time soon to come when that down payment is needed. Abby's youngest child is still in high school and will be applying to college next year. You place four years' worth of college costs in liquid investments staggered to mature at one-year intervals. You pay out the money if she isn't lucky enough to get a scholarship. The balance you invest in a mixture of assets that will provide income to the beneficiary, as well as increasing the value of the trust assets as you wait to see how this child develops.

Identifying the players

"All the world's a stage, / And all the men and women merely players. . . ."

—Shakespeare, *As You Like It*

The grantor of the trust may not have had Shakespeare's words in mind when creating the trust, but he or she has indeed set the stage for his or her wishes to be played out under the trust instrument. As trustee, identifying the players is one of your important first steps because you need to know who the beneficiaries and remaindermen are (you presumably already know the grantor if he or she appointed you as trustee) and if there are any co-trustees acting with you.



Here is a list of a typical "cast":

- **Grantor:** Sometimes called the *settlor,* this person creates the trust.
- **Trustee:** The person or corporation charged with safeguarding and managing the assets of the trust and making distributions to beneficiaries in accordance with the grantor's stated wishes in the trust instrument. The trustee can be either independent or non-independent (usually a family member), and trusts may have either type of trustee or both.

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- **Independent trustee:** An *independent* (or *professional*) trustee is one the IRS considers independent of the grantor and the beneficiaries for estate tax purposes. That way, the principal of the trust isn't included in the beneficiary's taxable estate upon his or her own death. The independent trustee may be either.
  - **An individual independent trustee:** An individual who is, hopefully, an expert in trust administration, such as an attorney, accountant, or enrolled agent.
  - **A corporate independent trustee:** A bank or trust company whom the grantor appoints as trustee. This entity always qualifies as an independent trustee.
  - **Family or non-independent trustee:** A *family* or *non-independent* trustee is one who is the grantor or a beneficiary (or is related to the grantor or a beneficiary in such a way that he or she wouldn't be considered independent for estate tax purposes). Grantors frequently use family trustees with independent trustees so that a family member or another non-independent source can give input on trust matters that don't affect the trust's tax status. As long as the family trustee doesn't have the power to make unrestricted distributions to himself or herself or to a dependent, he or she may participate in all other issues relating to managing the trust.

- **Beneficiary(ies):** Beneficiaries are those people or entities who/that have an interest in the trust, whether now (a *present interest*) or in the future (a *future interest*). An interest as a beneficiary can also be *contingent* (relying upon an event in the future that may not happen) or *vested* (not subject to any contingencies). For instance, a person who could only become a beneficiary if the current beneficiary dies during the first person's lifetime is a contingent beneficiary.
- **Remaindermen:** *Remaindermen* are those people or entities who will receive the trust property after an interest in it has expired. If, for instance, Uncle George leaves his property in trust for the lifetime of his wife, Aunt Rose, for her benefit, with the property to go outright to his nieces and nephews upon Aunt Rose's death, the nieces and nephews are the remaindermen.



You, as trustee, are balancing the rights of the current and future beneficiaries and the remaindermen when you make your judgments as to distributions of principal and trust investments. If principal distributions are discretionary, assets left in the trust to accumulate benefit later beneficiaries and remaindermen, and your decisions as to what mix of income earning and growth investments to hold in the trust affects both the income beneficiary and the remaindermen (see Chapter 12).

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Empowering the Trustee

The powers the grantor gives you in the trust instrument are crucial. Not only can these powers determine what the beneficiary(ies) receive from the trust and when, but the administrative powers also ensure the smooth running of the trust. You have to strike a critical balance here. Hopefully the grantor gives you enough powers to run the trust with ease, economy, and diligence without giving you enough power to hang yourself (metaphorically, we hope!).

Buying and selling assets

You, as trustee, typically have the power under the trust instrument to buy and sell assets (except for any unusual asset the grantor wants retained in the trust). Aside from any other specific directions in the trust instrument or state law, you must follow the *prudent man rule* — that is, to act as a prudent person would in managing their own affairs. In addition, most states have a *legal list* of investments that are suitable for trusts. (Chapter 12 gives you more detailed info about buying and selling the assets in the trust.)

Determining distributions to beneficiaries

The grantor can determine the frequency and amount of the distributions to the beneficiaries in the terms of the trust, or he or she can leave it to your discretion as trustee. If the grantor leaves it to your discretion, your job includes observing any guidelines set forth by the grantor in the trust instrument, and adhering to the overall intent of the grantor. The following sections highlight some of the types of distributions you may need to make as a trustee. Chapter 13 provides more in-depth info about paying specific distributions.

Income distributions

Frequently, trust instruments direct that all income is to be distributed at least quarterly. Alternatively, income distributions may be made at other specified intervals, or at your discretion. Very often, the distribution schedule is based on the age of the beneficiary so that younger beneficiaries often only receive discretionary distributions (great for paying for college while still keeping financial aid options open), and older beneficiaries may become entitled to mandatory income distributions. No two trusts are the same, so you need to be sure to read the instrument upon your appointment and then reread it periodically to be certain that you're still following the guidelines set out.

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Principal distributions

Distributions of *principal,* or *corpus,* are usually in the discretion of the trustee(s). The trust could also provide for no principal distributions, especially if the grantor wants to maintain the principal for a later generation of beneficiary.



Many trusts are set up with the intent of distributing the trust principal to the beneficiary over a period of time, usually between five and ten years, and at very specific ages (for example, a distribution of one-third of the trust principal at age 25, a half at age 30, and the remainder at age 35). Keep an eye out for this language as you make your plans for the administration of the trust and the investment of the assets, and mark those dates down in your calendar.

Trusts contain different standards for when principal distributions, if any, can be made to a beneficiary based on whether the trust has an independent trustee. The following are two reasons for different standards for principal distributions.

- **With no independent trustee:** If there isn't an independent trustee (and the trust is for the benefit of someone other than the grantor), the IRS has identified certain "magic words" that restrict the distribution of principal and keep the trust from being included in the beneficiary's estate for estate tax purposes. Although this structuring may seem incredibly technical, it's an important point, especially for the beneficiary and his or her heirs. The magic words that keep this trust out of the beneficiary's estate are "health, education, maintenance, and support," which constitute an *ascertainable standard*.
- **With an independent trustee:** Unfortunately, *comfort* isn't one of the IRS's magic words; using the word *comfort* makes a trust taxable in a surviving spouse's estate. Because many grantors feel the ascertainable standard described previously is too limiting, especially in a trust for the surviving spouse, grantors frequently elect to have an independent trustee so that the grantor can bestow broader powers of principal distribution without causing adverse tax consequences to any party.

Hiring and firing advisors

The grantor and the person drafting the trust instrument understand that not every trustee will be a wizard at all aspects of trust administration, so trust instruments typically give the trustee the power to hire and fire advisors. Look for this power in your trust instrument. If you do decide to hire an advisor, check out Chapter 4 for more specific advice about finding out what's a good fit.

After all, your grantor wants you to have any advice you need to run the trust and fulfill your fiduciary duty. And, if an advisor isn't working out, including one whom the grantor has chosen, you need the power to let the advisor go —

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whether for personal incompatibility with the trustee or a question of competence. If you feel you've given an advisor a fair chance to prove himself to you (and fair is defined by you as trustee, unless your trust instrument provides otherwise), then by all means fire him and hire another of your choice.

Coloring inside the Lines: Understanding Fiduciary Duty and Limitations

As a trustee, you have a *fiduciary duty* to the trust; that is, you must always act in accordance with the terms of the trust and in its best interests and the best interests of its beneficiaries and remaindermen. Your fiduciary duty is further spelled out in the governing state law and in court cases in that state over the years. Your attorney can advise you as to the law regarding your duties and limitations as any questions arise. Your failure to fulfill your fiduciary duty or overstepping your powers as trustee can lead to the beneficiaries taking legal action against you. To avoid any potential lawsuits or problems, this section provides you with some important points you need to remember when administering a trust.

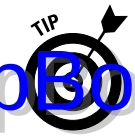
Exercising discretion

How much power you have to exercise discretion in your role as trustee depends on the language of the trust instrument, some of which is dictated by tax law if you're a family trustee. The grantor, in choosing you, gave you a framework within which to work, but he or she also trusted you to make the best possible choices when circumstances dictate. In our experience, circumstance almost always dictates at some point or other.

Whether you have a great deal or only a tiny amount, some discretion is necessary as trustee. You must be able to make and change investments in a way you feel benefits the trust; for example, even if you're following the prudent man rule. And you must have some discretion in whether or not to make principal distributions (if principal distributions are allowable).

As trustee, you're often in the position of acting in place of the grantor, and somehow, you're expected to do what he or she would have done in the same situation. Sound impossible? It is, but that doesn't excuse you from trying your best. Obviously, the closer your personal relationship with the grantor, the more likely you'll be to act in a way the grantor would have approved of. So, when you're faced with the question of whether to pay that school tuition bill for one beneficiary, buy a car or a house for a second beneficiary, or bail a third beneficiary out of jail for the third time, applying what you know about the grantor to the question at hand may well provide you with the guidance you need to make these sometimes sticky decisions.

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So, when faced with a decision, what do you do? Never make distributions willy-nilly, but document everything that you're asked to distribute by the beneficiary. If you're helping him or her to buy a house, make sure that you have copies of all the house purchase documents. If it's school tuition that's on the line, keep a copy of all the school bills you pay. And if you choose to bail someone out of jail, keep the receipt from the bail bondsman. Of course, if you opt to leave him or her there in timeout to think, write a memo to the file, laying out your reasoning for that decision, too.

Obtaining errors and omissions insurance

At one point in time, no one would have dreamed of suing a trustee. But in these litigious times, no one is immune to lawsuits, and that includes you in your role as trustee. So in order to protect yourself, don't forget to obtain *errors and omissions insurance.* This insurance protects against claims by beneficiaries that you haven't fulfilled your fiduciary duty in the management and administration of the trust. Contact your insurance broker about obtaining this insurance, which is a deductible trust expense.



Without errors and omissions insurance, if you make a mistake in administering the trust, no matter how unintentional, a disgruntled beneficiary can go after you and your personal assets. If you have insurance coverage, the insurance company will defend you against a questionable lawsuit, because it won't want to pay out a claim unless it feels the claim is justified. Buying this insurance is money well spent.

Protecting the Trust's Assets

Among the myriad of duties you assume as trustee is a duty to protect the trust assets. In today's financial world, protecting the assets most likely doesn't mean hanging on to those assets with which the trust was funded — unless those assets consist of shares of a closely held business, a family-owned farm, or the like that the grantor specifically instructed be retained in the trust.

In that case, you fulfill your duty as trustee by retaining the asset and seeing that it's managed as competently as possible. However, barring an instruction in the document to retain specific assets, as trustee you must constantly look at the assets to see whether they're the most appropriate to serve the trust purposes. This section gives you the 4-1-1 on how to guard the assets.

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Diversifying the assets

"Don't put all your eggs in one basket" doesn't just apply on the farm. One of the cornerstones of today's investment philosophy is to diversify assets into different classes, such as stocks and bonds, and into different industries, such as transportation, healthcare, consumer goods, energy stocks, and so on. That way, you spread the risk among several classes of investments and several industries, and the danger of overall loss lessens. This theory is that not all investments respond in the same way to all market conditions, so you're better prepared for market changes in one class of asset or one industry if you're invested in several. Diversified mutual funds or mutual fund families can be one answer to diversifying assets in a smaller trust.

Unlike investing your own money, where you're allowed to invest in anything that's legal, investing as a trustee requires that you exercise due diligence in researching investments and assume only moderate risk. Speculating, although not specifically prohibited, is strongly discouraged. Your goal shouldn't be to scale great heights but rather to allow modest gains and prevent drastic losses. Chapter 12 gives you more detailed info about investing the trust's assets.



Failure to adequately diversify the assets held inside the trust (except those assets which the grantor specifically requires that you retain) can leave you open to accusations of incompetence (or worse) from the trust beneficiaries or remaindermen. If you choose an investment policy that runs counter to the standard wisdom, document your reasoning and be prepared to defend your choices — in court, if necessary.

Asking for help



Getting recommendations — by word of mouth, from other professionals, and even from advertisements — is great, but be sure to check them out thoroughly, including a call to the Better Business Bureau to see whether any complaints have been filed against them. The following are some professionals you may find useful:

- **Investment advisors:** An investment advisor is a person or company who advises the trustee as to what investments to make given the purpose of the trust, its size, and the needs of the beneficiaries. If you choose to use an investment advisor, always use one that charges a fee for services, not one who receives a percentage of sales!

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- **Trust companies, banks, and brokerages:** Trust companies and banks that have trust departments can be useful for holding the assets of the trust. They can prepare periodic statements, annual accounts, and income tax returns and also invest the assets (all for a fee, of course). Trust assets may also be placed in a brokerage account or accounts, which provide you with periodic statements and investment advice. Generally, the fees involved in this option are for trades. Some brokerages prepare annual accounts and tax returns for an additional fee; others don't. If you need this service, ask before you open the account.
- **Lawyers, accountants, and enrolled agents:** Lawyers who specialize in trust law can be useful to you in interpreting the trust document and guiding you as to state law and your role as trustee. Depending on individual state laws, law firms may also have trust departments, where the assets of the trust can be invested and the trust can be administered. Accountants and *enrolled agents* (tax professionals licensed by the U.S. Treasury Department) who are familiar with trust administration can prepare accountings and income tax returns.

See Chapter 4 for choosing the appropriate professionals to help you.

Preparing and Filing Annual Income Tax Returns and Accounts

As trustee, you're responsible for preparing annual accounts and income tax returns or having them prepared by the appropriate professional. Don't forget that, whoever prepares them, you're responsible for their contents, so review them carefully!

If the trust was created under a will rather than under a separate trust instrument, you must file annual accounts with the probate court (or its equivalent in your jurisdiction) and have them allowed by the court. Trusts under wills are a rarity nowadays, precisely because they require court supervision. We don't even attempt to go into detail here on the details of allowance of such accounts.

When you have the annual accounts ready, send copies to all current beneficiaries along with a document by which he or she assents to the account. See Chapter 15 for more specific details regarding preparation of annual accounts and Chapter 18 for how to prepare the income tax returns.

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Chapter 11
Funding the Trust

In This Chapter

- Moving assets into the trust while the grantor is alive
- Reregistering existing assets
- Funding a trust after the grantor's death

The trust instrument has finally been signed. You've agreed to serve as trustee and have also had a chance to look over the provisions of the trust, so you probably have a good idea what you may and may not do as trustee. Now you have to identify the property that belongs in this trust and figure out how you're going to move it from point *A* (the grantor's possession), to point *B* (the trust).

This chapter explains how to transfer all sorts of property and what special considerations you need to make allowances for. We show you how to make sure the transfer process is smooth and alert you to possible gift tax consequences for transfers made during the grantor's lifetime.

Putting Assets in Trust during Life

If you're the trustee of a trust whose grantor is still living, or if you're both the trustee and the grantor of a trust that's ready to start operations, you're probably ready to start moving *assets* (items of value owned by any entity) into the trust. For example, the grantor may have designed the trust to avoid probating certain assets and/or to make everything accessible for the grantor's benefit if he or she becomes incapacitated. (To verify the trust's purpose, refer to Chapter 3.)



Whatever the reason for establishing a trust, now that it's up and running you need to give it something to run on: assets. Before you begin to transfer assets into the trust, have the following documents handy:

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- **Certified copy of the trust instrument:** Usually just a photocopy of the instrument, with the words, "A True Copy. Attested by" typed on the front page, and the trustee's original signature. You may make multiple certified copies, but all must have original signatures on the front page.
- **Federal Taxpayer Identification Number:** If you haven't already applied for one, you absolutely need one (unless the trust's a revocable living trust [see Chapter 3] in which case you may use the grantor's Social Security Number during the grantor's lifetime) before you can open any accounts or transfer any assets. Check out Chapter 18 to find what you need to do in order to obtain this number.
- **Proof of ownership:** You must show documentation that proves the grantor owns the property before you can transfer it to the trust; for example, a deed to real estate, stock and/or bond certificates, or bank or broker account statements.

Depending on the type of property you're transferring, you may also need new registration forms, signature cards, or other documents; the company where you're transferring the property will provide the necessary forms.

Sign it Over: Giving the Trust Asset Ownership

When funding a trust during the grantor's lifetime, you may be changing ownership of many types of property, from money, securities (stocks and bonds), and real estate to life insurance policies and all sorts of personal property. Basically, when you change the ownership of a piece of property to the trust, you're transferring title from the grantor's name to the name of the trustee. For instance, a bank account held in the name of James E. Jones is transferred to Martha A. Jones, Trustee of the James E. Jones Trust *UTA* (under trust agreement) dtd. 02/11/08.

No matter the type of property, you must document all transfers from the grantor to the trust. This section highlights the different types of property that can be transferred and how you can address each kind.

Cash and securities

Although all sorts of assets can be held in trust, cash and securities are two assets commonly used to initially fund the trust. And with the advent of technology, funding the trust with cash and securities is quick and easy.

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Funding with cash and securities is as old as the hills; what's changed is exactly how it's done. The days of someone handing you a folder filled with stock certificates are largely gone, replaced by securities held in so-called *street* or *nominee* name, where your record of ownership is maintained either by the company who issued the shares or bonds, or by a brokerage firm or bank. And, even though cash (and checks) haven't entirely gone by the wayside (one of us once had someone hand her a $10,000 cashier's check to fund a trust), sending large sums over the Federal Reserve wires is far more common.



After the new custodian(s) for the property have assured you that they've received all the assets, double-check to make sure that all the assets have left the first custodian and arrived safe and sound at the second. The transfer often takes more than one try to get right. In fact, one of us was involved in a trust where one $500,000 bond took a three-year long detour into never-never land. Follow up on your transfers (on both ends) with phone calls, but always ask for an account statement or some other written evidence that the property is where it should be and that it's been correctly titled.



You may transfer cash and securities in the following ways, depending on how the assets are held to start with and where you want them to end up.

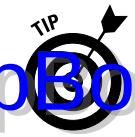
Transfers within the same financial institution

If the cash or securities being transferred are already in the hands of a financial institution in street name and you're changing only the ownership registration, all you have to do is set up new accounts (to hold cash, securities, or both) in the name of the trust. The bank or brokerage will provide you with the necessary paperwork, such as account applications, signature cards, and **Form W-9, Request for Taxpayer Identification Number and Certification.** After the paperwork is complete, the grantor can initiate the transfer of the property into the trust's account.

Transfers from one financial institution to another

If you're moving the cash or securities from one financial institution to another and need to change the ownership registration, you still need to complete the same documentation and account opening forms as with transfers within the same bank or brokerage firm. However, the whole process just takes longer because in our experience the institution losing the property drags its feet because it doesn't want to lose that business and the fee it generates. Make sure that the current institution gets the grantor's letters directing the transfer (certified or registered mail is the way to go here), and then follow up with phone calls.

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You can speed the process along if you obtain cash wire-transfer information from the receiving institution and pass it along to the sending one. And don't forget to get the new custodian's *delivery instructions*, or the specific routing and account numbers for the new custodian's receiving account, for any stocks and bonds you're having transferred. Just be sure that you carefully copy down what you're told and review the instructions with the new custodian for accuracy before you send them along to the old custodian.

Reregistering stock and bond certificates

Although we definitely don't recommend it, sometimes you're faced with no alternative but to hold physical certificates, which you'll recognize by the heavy paper, fancy designs, and colored inks. The simplest way to change the registration on them is to reregister the securities from the grantor's name into the name of the trust. The following are a couple of important points to keep in mind when reregistering certificates:

- The grantor must mail the physical certificates back to the issuing company with his or her written instructions.
- In a separate envelope, the grantor should mail *stock powers*, each of which includes the grantor's name, the company name, the number of shares (or face value of the bond), and the new owner's name. Stock powers must be signed by the grantor and typically also require a *signature guarantee,* or a stamp or seal from a commercial bank or stock brokerage.

The company will cancel the old certificates and issue new ones. If you have a lot of stock powers to prepare, you can get pads of blank powers from your local legal stationery store or get one blank form and make photocopies.



Although transferring securities from the grantor into the trust isn't rocket science, it does require that you move carefully and methodically. Here are a few suggestions:

- **Use registered mail when transferring physical securities.** You want a record that you sent them, and an acknowledgment of receipt.
- **Never sign a blank stock power.** Put that together with a stock certificate registered to the power's signer, and you've just put what is essentially cash into an envelope; anyone can walk away with it.
- **Never sign the stock power located on the back of the stock certificate.** Always use a separate document, and make sure that you mail it (registered) in a different envelope than the stock certificate.
- **Keep all stock and bond certificates locked safely away in a safe deposit box until you need them.** These documents are sometimes extremely valuable (worth far more than the paper they're printed on) and replacing lost, stolen, or destroyed certificates is costly and time consuming. If you need to reference what's on these certificates, photocopy them and place the copies in a file, keeping the originals locked away.

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If you've just finished reregistering physical securities, and are in possession of all the replacement certificates, you may want to move them into street name by opening a securities account with a bank or a brokerage. The bank or broker can help you fill out any forms to make that change. After the transfer into street name is complete, your job becomes much simpler because interest and dividends are paid directly into your account, and you needn't deposit a multitude of sometimes-miniscule checks.

Privately held stocks, promissory notes, and limited partnership interests

Many grantors set up trusts with the intention of funding them with non-publicly traded securities, such as "S" corporation stocks, promissory notes, and limited partnership interests. Grantors do this to avoid probate issues and maintain privacy, in the case of *revocable trusts* (trusts the grantor creates and funds during lifetime to avoid probate, but not intended to remove the items from the grantor's taxable estate; see Chapter 3), or to remove items that have the potential for vast increases in worth over time from their estates and estate tax returns.



Whatever the reason, moving these types of assets from personal ownership into a trust is a reasonably simple matter. What's important is that you carefully document the transfer's completion. That is, make sure that you have something in writing showing the stock certificate in the trustee's name, or the assignment of the promissory note to the trustee, or the limited partnership interest in the trustee's name. The typical way to hold title in trust name is as follows: X (and Y, if there are two trustees), Trustees of the JJD Trust, UTA dtd. 02/11/08. *UTA* stands for under trust agreement, and *dtd.* is the traditional abbreviation for dated in this context. Slight variations on this wording are acceptable.



Check out the following to determine what you need to do to change ownership for these three types of property:

- **Privately held stock:** With this stock, such as stock in family corporations (including "S" corporations), follow the guidelines in the preceding section for reregistering stock certificates. Complete separate stock powers, which are necessary even though signature guarantees typically aren't. And remember, you can't register privately held stock in street name, so the corporate clerk, secretary, or the corporation's attorney must type up new stock certificates in the name of the trust.
- **Promissory notes:** A grantor may lend money to a third party and decide to place the promissory note into the trust. He or she may transfer the note to the trust by executing an assignment of the note to the trustees. It's a simple document, but case specific. You can ask whoever drew up the note to draft the assignment. The grantor may transfer it to preserve

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privacy, to remove the note from the probate estate, or to make a non-cash contribution. After all, the money has already been lent; even though the piece of paper showing the loan represents real value, the cash has already left the building. When the grantor assigns the note to the trust, the grantor must notify the borrower to make future payments of principal and interest directly.

- **Non-publicly traded limited partnerships:** These are a popular way of owning real estate with a group of like-minded investors. To transfer a limited partnership interest into a trust, the grantor must notify the *general partner* (the partner who's running the partnership) of his or her intent, in writing. An *assignment of partnership interest* is a more formal way to accomplish the transfer, but a letter signed and dated by the owner of the interest should work. The general partner will then change the records of the partnership. Stay on top of this transaction. Keep after that general partner until he shows you that the records of the partnership have been changed to reflect your transfer to the trustee(s) of the trust.

Real estate

Depending on what state real property (real estate) is located in, transferring real estate into trust can be quite simple. The following should happen:

Step one: The grantor transfers the property's title

The grantor transfers title in the property either directly to the trust, or in some states, to a nominee partnership. A *nominee partnership* is an entity that acts as owner of the property on behalf of the trustee (to avoid the necessity of recording the trust instrument in the registry of deeds and turning it into a public record).

By executing a new deed to the property and filing it with the appropriate government office, the grantor completes the transfer in most cases. This new deed is sometimes referred to as a *grant deed, quitclaim deed,* or *warranty deed,* depending on what level of protections exist within the deed to safeguard the owner's interest and on what state houses the real estate. The new deed usually goes to the local Registry of Deeds or its equivalent; in the case of *registered land*, which exists only in certain states, the deed goes to the local land court to complete the transfer.



In some states that limit property tax increases to an annual percentage, transferring real estate may force the property's reappraisal and trigger large property tax increases. Check the rules in your state prior to making the transfer. After the transfer is complete, you can't change your mind.

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Step two: You draft a new deed

If you have the original deed, drafting a new deed is easy. Simply copy the old one in all respects except for changing the names of the parties (and, depending on state law, using a quitclaim deed form rather than a warranty deed, because it's a gift). For example, on the new deed, the name of the grantor replaces the name of the person the grantor originally acquired the property from, and the name(s) of the trust or trustee(s) replaces the name of the grantor on the old deed. Depending on state laws, you may need to specify the trustee capacity of the trustees; for instance, the new deed may name "James Doe, Trustee, and his successors, of the John Smith Irrevocable Trust."

You must also check on what, if any, constitutes the standard *consideration* (money and/or other factors that induce the grantor to *execute,* or sign, the deed) in your state in the case of a gift. On the new deed, the consideration may be worded something like "for $1 and other good and valuable consideration." Even though the transfer is a gift, most states require that some consideration be stated on the deed.

If you don't have the original deed, go to the local register of deeds office where the real estate is located and ask how you can best locate the record of that deed. If you aren't up to going through their dusty old books, or you aren't nearby, you can hire someone to do a title search for you. You can likely get a name at the Registry of Deeds.



If an attorney didn't prepare the deed, have one review the deed before signing; you don't want to mess up the deed. A problem with the deed can affect *clear title* (no legal questions as to ownership) to the property.

Step three: The grantor signs the new deed

The grantor signs the new deed in the presence of a notary public, who affixes his or her official seal (and, in some states, two witnesses). Requirements regarding additional witnesses vary by state; the original deed that you copied from will show how many witnesses your state requires. Record the new deed with the Registry of Deeds or the land court to complete the transfer.



Some real estate is encumbered by a mortgage, and banks and mortgage companies don't look kindly on you transferring property in which they hold a secured interest. Don't attempt to transfer mortgaged property from the grantor into the trust without first obtaining the mortgage company's approval, in writing. The mortgage company may well be congenial to the transfer, but it will require you, as trustee, to assume the grantor's mortgage. It will undoubtedly have documents that you must complete, sign, have notarized, and record along with the new deed.

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Step four: After the trust owns the real estate, you, as trustee, assume all responsibility for the property

After the trust officially becomes the owner of the real estate, you, the trustee, assume all the responsibilities for that property. Don't forget to pay the mortgage, if you have one, or the real estate taxes. And absolutely don't forget to insure it, and be sure that your name as trustee is on the insurance as an insured. If you have a mortgage on the property, the mortgage company will be certain to remind you, but when you own that property free and clear, it's sometimes easy to let certain things slide. Of course, should the property be damaged, or should someone be injured on the trust's property, you as trustee may well be held liable if you've failed to adequately insure it.

Life insurance policies

Life insurance policies come in many flavors, and they guarantee a reasonably large cash payout down the road for a relatively small investment now. A life insurance policy can fund a trust that eventually creates some available cash for future expenditures, such as anticipated estate taxes. No matter what type, life insurance policies may be acquired by a trust in two ways: The trustee may purchase a policy on the life of the grantor, or the grantor may transfer ownership of an existing policy into the trust.

Because life insurance trusts are generally not funded with large amounts of cash or securities, the grantor typically makes a large enough gift into the trust each year to pay the annual premium and any fees and expenses the trust may incur. The sole asset in the trust (other than small amounts of cash or money market funds) is the insurance owned by the trust on the grantor's life. When the grantor dies, the face value of the policy pays into the trust, bypassing the grantor's estate entirely.

The following sections outline the two ways a trust can acquire a life insurance policy.

Policies purchased by the trustee

When you, the trustee, purchase life insurance on the life of the grantor, you're responsible for contacting an insurance broker and negotiating the terms of the policy. You'll typically only be doing this if the trust was set up as a vehicle to own life insurance (for instance, a Crummey Trust; see Chapter 3). Of course, if you're not an expert on life insurance, you'll want a third party looking over your shoulder. Some attorneys who work with life insurance trusts have become quite expert at analyzing the benefits of various insurance policies. And you'll want a highly recommended insurance broker. In addition to relying on friends' and family's recommendations, check with your state's Secretary of State, who licenses insurance brokers, to make sure that the broker you choose has no black marks on his or her record.

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As part of the underwriting process, the grantor may be required to take an insurance-company physical so that the insurance company can determine premiums based on the state of the grantor's health.

Policies gifted into trust by the grantor

Sometimes, the grantor makes a gift of an existing insurance policy into the trust. It could be a policy on which premiums are still being paid or it could be a *paid-up* policy, where all the premiums have been paid and the policy remains in force until the grantor's death. In either case, an existing policy is an excellent candidate for transfer to the trust because, should the policy remain in the grantor's hands until death, its face value would be included in the gross estate (see Chapters 16 and 17), and a large percentage of the proceeds from the policy would go to pay estate taxes.

To transfer a life insurance policy into the trust, the grantor must complete and sign an assignment or transfer of policy. Be certain to obtain **Form 712, Life Insurance Statement,** from the insurance company at the time the grantor makes the transfer. The value on **Form 712** is the value the grantor declares on his or her **Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return**, if any is required.

By gifting the policy to the trust, the grantor limits the includable value on his or her estate tax return to the value as of the date of the gift, not the policy's face value. And because no policy prior to the insured's death is worth much in comparison to its value after that death, making this transfer now saves tens or even hundreds of thousands of dollars in eventual taxes if the grantor has a taxable estate.



After the transfer, it's up to you, as trustee, to make sure that the endorsements on the policy (that list information like whose life is being insured, who owns the policy, and who gets the money when the insured dies) are changed. You need to be certain that the trust is not only named as the owner but is also designated as the beneficiary. For instance, the new ownership and beneficiary designation should now read something like this: "John Q. Doe and Thomas H. Doe, Trustees, and their successors, of the John M. Smith Irrevocable Trust, under trust agreement dated 02/11/08." And don't forget to pay those annual premiums if the policy isn't paid up. Be sure that you have cash in advance of the payment date every year (from the grantor) to pay the premiums. For a Crummey Trust, you need to send Crummey notice letters to the beneficiaries while the cash is in the trust and before the premium is paid (see Chapter 3).



Frequently, transfers into irrevocable life insurance trusts (whether cash for premiums or policies with cash value) trigger the need for the grantor to file **Form 709,** for each year that he or she makes transfers into the trust in excess of the annual exclusion ($12,000 in 2008).



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Eyeing the types of life insurance available

All life insurance policies contain an element of *term insurance*, or pure insurance that provides coverage for a set period and builds no cash value. Failure to pay scheduled premiums causes the policy to lapse, usually 30 days after the due date of the missed premium. Besides term insurance, here are some other types of life insurance you may encounter:

- **Whole life:** Combining term life coverage with a modest investment motive. Generally, whole life remains the same, year after year, with a portion of the premium paying for term coverage. The remainder is invested by the insurance company, and provides the policy owner (that's the trust) with a stated rate of return. Policies build cash value, so should you decide to terminate the policy prior to the death of the insured, you're entitled to a return of any cash value accumulated within the policy. At the death of the insured, the policy pays the face value, but any cash value existing prior to death is erased. Should you fail to pay a premium, the cash value continues making premium payments until it's exhausted. Only after cash value has been exhausted does the policy lapse.
- **Variable universal life:** Similar to whole life, except the cash value in the variable universal life policy may be invested by you in a variety of mutual funds offered by the insurance company. When the stock market does well, the policy's cash value increases; when the stock market performs poorly, so does the policy's cash value. Like the whole life policy, the face value of the policy is paid into the trust when the insured dies. Missed premium payments are made with the existing cash value until it's gone, and then the policy lapses.
- **Single premium life:** The one-payment plan, single premium life lives up to its name. The insured purchases a policy with one giant premium payment, which the insurance company calculates based on the insured's health and age. Be cautious of single premium life — although insurance companies market this plan as "one payment covers you forever," they may run through the pool of available cash quicker than planned if they invest poorly, and come back to you years later looking for additional premiums, and if you don't pony up, the policy lapses.

Personal and household property in trust

If the grantor has established a revocable trust (see Chapter 3 for more info), he or she can transfer some or all of his or her personal and household items into the trust by means of a one page declaration, notarized and witnessed. Figure 11-1 shows a sample that's been successful in avoiding probate.

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DECLARATION OF TRUST OWNERSHIP
AS TO ALL
PERSONAL AND HOUSEHOLD ARTICLES

The undersigned hereby declare that, solely as Trustees of and nominees for the benefit of the JILLIAN J. JONES 2008 TRUST, a revocable inter vivos trust existing under a certain declaration of trust heretofore executed on even date herewith by JILLIAN J. JONES as Settlor with JILLIAN J. JONES and HARRY M. JONES as the initial Trustees, they (i) are acquiring or now hold and (ii) will hold, pursuant to the provisions of subparagraph 9 of Paragraph A of Article XII of said declaration of trust, solely and exclusively for and in behalf of said trust, the following personal and household articles (the beneficial ownership of which JILLIAN J. JONES hereby transfers to said trust):

All of her jewelry, clothing, household furniture and furnishings, personal automobiles, and all other tangible articles of a household or personal nature, or any interest in such tangible personal property, together with all policies of insurance on such property, which she presently owns or hereafter acquires regardless of the means by which acquired.

This declaration of trust ownership is intended to be and shall be binding upon JILLIAN J. JONES heirs, administrators, executors and assigns and shall be revocable and amendable only by written instrument executed by one or more of the then Trustee(s) of said trust (with or without indicating such fiduciary capacity) with all the same formalities as accompanied the execution of this instrument (provided, however, that this declaration may be terminated by JILLIAN J. JONES, individually, by written notice to the then Trustee(s).

This declaration is intended to revoke all prior declarations of ownership, if any, with respect to any and all properties governed by this declaration heretofore executed by JILLIAN J. JONES.

IN WITNESS WHEREOF, JILLIAN J. JONES has executed this instrument this 26th day of August, 2008.

Witnesses: Jillian J. Jones

Harry M. Jones

COMMONWEALTH OF MASSACHUSETTS)
)
COUNTY OF MIDDLESEX) August 26, 2008

Then personally appeared the above named JILLIAN J. JONES ad HARRY M. JONES, and acknowledged the foregoing instrument to be their free act and deed, before me.

Notary Public
My commission expires:

Figure 11-1: Declaration of Trust Ownership as to all personal and household articles.

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If the grantor has funded an *irrevocable trust* (a trust that can't be changed or revoked by the grantor; check out Chapter 3), he or she definitely doesn't want to include household and personal property (except for, possibly, items that have the possibility of increasing in value greatly during the grantor's lifetime, such as artwork by a well-known living artist who's in poor health). Remember, transfers into an irrevocable trust mean the grantor is giving up all right, title, and interest in the property. If that property remains in the grantor's house, and the grantor continues to use it, the IRS would be well within its rights to question the validity of the transfer and disallow the gift.

Rolling Property into Trust after Death

Often, trusts are created during the grantor's lifetime, but they aren't funded until after the grantor dies. If you're a trustee of a trust where the grantor has died and you need to fund the trust, you have

- **To assist the executor of the estate in making an orderly transfer of assets into the trust.** Usually, when trusts are funded only after death, the majority of assets flow through the decedent's estate. Probate assets must go through the probate process (see Chapter 6), all debts of the decedent and the estate must be paid (including all estate taxes), and all legacies and bequests must be honored prior to making distribution from the estate into the trust.
- **To identify any assets that became payable to the trust directly upon the grantor's death, such as insurance policies owned by the grantor with the trust named as beneficiary.** Chapter 8 tells you what you need to know (and what to look for in the decedent's Last Will) to determine whether this trust should be funded with specific assets, a specific dollar amount, or with a percentage of the assets. You may also find guidance as to whether to include or exclude certain property from the funding.

Be careful when funding a trust: Not all available property is eligible. You may not fund a trust with the decedent's 401(k) plan, for example. Very often, the estate is clearly more than large enough to fund the trust even after all other obligations are met. In that case, you (together with the estate's executor) may decide to partially fund the trust earlier than you have to so that trust beneficiaries who may be relying on trust income for their living expenses may begin receiving distributions. Early funding of the trust must be done with the absolute understanding between the trustee and the executor, in writing, that the trust will honor any financial obligations the estate can't meet.

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Chapter 12

Investing the Trust's Assets and Paying Its Expenses

In This Chapter

- Figuring out how to differentiate between income and principal
- Choosing investment advisors
- Understanding diversification
- Investing in a socially responsible way
- Using trust assets to adequately provide for beneficiaries' needs
- Knowing which expenses you can and can't pay from the trust

Unlike an estate, a trust is an ongoing endeavor, and its lifetime may well be longer than yours. Your duty as trustee is to manage the trust's assets to ensure that the trust's beneficiaries will have adequate funds when they need (or are entitled to) money. Your goal is to see that the asset base grows, not to keep it the same or see that it shrinks.

In order to make your tenure as trustee a successful one, this chapter explains what you need to know about separating principal from income. It also shows some basic investment options, some of which you may decide to use to invest the trust assets and others of which you may think aren't for you, at least not now. The beauty of being trustee, as opposed to executor, is that yours tends to be more of a long-term role, so you have the option of investing one way now and then changing it up later if it's not working the way you want. Whichever you decide, remember that your goal isn't just to preserve the assets but also to put them to work for the benefit of the beneficiaries and the remaindermen.

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Eyeing the Importance of Income and Principal in Trust Administration

Picture a trust as two boxes. In one box, you keep all the property that's available to produce ordinary income like dividends, interest, or rents. When that income is earned, it goes into the second box. As you make payments, some may come out of either box depending on what you (the trustee) decides; others, such as beneficiary payments, come only from the income box, assuming it has income in it. Knowing how to differentiate what belongs in the principal box from what should be in the income box is one of the trickiest concepts to grasp in trust administration.

To help you get a firm grasp on principal and income, this section gives you a clear definition of each and explains why and how you can differentiate between the two to help you manage your trust.



Being able to allocate money to either the income or principal sides of a trust is a key element in successful trust administration because the people who are entitled to receive income may not be the same people entitled to receive the principal when the trust terminates. One of your many jobs as trustee is to make sure that you don't favor the income interest over the principal interest, or vice versa. You must be fair and equitable to both.

Defining principal and income

Defining principal is quite easy. *Principal,* sometimes referred to as the *corpus* or *body,* of the trust, is the property that the trust owns. Principal may include cash, but it may also be stocks, bonds, real estate, business interests, country club memberships, or season tickets to the Met. In fact, anything that the trust can be said to own is principal. Although trust principal starts with the assets that originally fund the trust (see Chapter 11), it may increase or decrease when the sale of trust property creates capital gains or losses; when the grantor makes additional contributions to the trust; when the trust receives a settlement or judgment as a party in a lawsuit; or even when you transfer into principal any accumulated income that's not required to go to an income beneficiary.



Principal in a trust can shape-shift without ceasing to be principal. A common misconception is that when you sell an asset, the cash proceeds that you receive become available to pay the income beneficiary. After all, if you sell something in your personal finances, you can use the cash you receive to pay any of your bills. But that's not the case in a trust, where the cash received from the sale of any asset still remains a principal asset, albeit in a different form. So in the hands of the trust, stock worth $100 is the same as the $100 cash it receives from the sale of that stock, which is the same as the $100 of different stock that the trust turned around and purchased with the cash.

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As for income, the definition is extremely simple. Almost everything earned by the principal of the trust is *income.* So stock dividends, interest earned on bank accounts or bonds, rents from real estate owned by the trust, and earnings received from a business the trust owns all constitute income of the trust. In fact, if you receive a payment of any sort and you're not sure where it belongs, you're probably safe in depositing it to the income side of the trust, with a few exceptions we outline in the next section.

Understanding the distinction between the two

A great deal of your success as a trustee lies in your ability to determine what's principal and what's income. Your assignment of all receipts to either the income or principal side of the trust dictates how you calculate *trust accounting income,* an amount that determines how much money the income beneficiary is entitled to receive. By understanding the difference between the two sides of the trust and applying your knowledge, you can give the income beneficiary the amount he or she is due (or something close — much of the equation is based on your best judgment as trustee) and hopefully keep everyone happy.

So why does making the distinction between principal and income sometimes seem so difficult? Well, not every type of principal or receipt of income is straightforward, and sometimes figuring out what you have can be perplexing. The largest exception to the income/principal distinction is how you classify capital gains and losses. *Capital gains* occur when you sell a piece of property for more than your acquisition cost (either because the trust purchased the property or because it received the property from the grantor or the grantor's estate as a part of the trust's initial funding). See Chapter 11 for more info. *Capital losses,* on the other hand, are what you get when you sell property for less than your acquisition cost. Whether the trust generates gains (hopefully) or losses (not too often, but sometimes unavoidable), those gains and losses stay on the principal side of the trust.



You also need to be aware of two other tricky types of principal payments you may receive on account of trust assets. Those two types are

- **Return of capital:** When you receive a *return of capital,* the company that has issued this payment has essentially determined that some part of what you owned no longer exists, and so they issue payments that reduce your acquisition cost. To the extent that you still have an acquisition amount for that particular piece of property, you reduce that amount by the return of capital, record any cash you receive on the principal side of the trust, and don't recognize income of any sort. For example, QZW Corp, which you purchased for $10 per share, later sells off one wicket-manufacturing plant. It sends you a check for $3 per share

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as the proceeds from the sale of the wicket-manufacturing plant as a return of capital. Your new acquisition cost in QZW Corp is now $7 per share ($10 original purchase price – $3 return of capital), and you have no capital gain or loss on the transaction.

- **Special or extraordinary dividends:** With a *special* or *extraordinary dividend,* on the other hand, the corporation has issued a larger than ordinary slice of the corporate profits. These extraordinary dividends are typically allocated to the principal side of the trust, because their payment almost always causes the share price of the stock to drop by at least the amount of the dividend. For example, in November 2004, Microsoft issued a $3.00 per share extraordinary dividend, as opposed to its quarterly $0.08 per share dividend. Not so coincidentally, Microsoft's share price dropped that very day by almost exactly the same amount as the dividend. Unlike the return of capital, an extraordinary dividend doesn't reduce the trust's acquisition cost.



If you understand the distinction between income and principal, you should have no difficulty in correctly allocating payments such as returns of capital or extraordinary dividends; however, sometimes the company itself isn't clear on how it should categorize these payments until long after it has actually made the payments. If the correspondence you receive from the company is confusing (and we've read more than our share that boggles the mind), you may want to check in with a tax professional who can help walk you through the correct application of the payment.



Most trust instruments include a provision that states that the final determination of what's principal and what's income rests with the trustee. Trust administration isn't a precise practice, and the lines between principal and income sometimes blur. If you're not sure what something is, you may want to seek professional advice from an accountant, enrolled agent, or attorney who specializes in trusts.

Using Investment Advisors Effectively

Investment advisors can make your life as trustee easier. They spend 100 percent of their professional time researching companies and reading balance sheets and annual reports. Their job is to be on top of whatever type of investment they specialize in so that you don't have to. Check out Chapter 4 for some of the different types of advisors available to you and how to select one or more.

In fact, both of us would most definitely choose to use investment advisors for trusts we were responsible for. Although we're both extremely competent in lots of areas of trust and estate administration, neither of us want to have the absolute decision of what to buy and sell (and when) resting on our heads.

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Your job is to be very specific as to what your expectations are when hiring an investment advisor. When hiring an advisor, keep the following points in mind:

- **Set boundaries.** If you don't give an advisor parameters, you're giving too much responsibility to someone whose loyalty to you extends no farther than the size of the fee you're paying. You can reasonably assume that the advisor probably doesn't want to lose your business, but unless you show them otherwise, they'll probably assume that you have no idea what they're doing, won't be able to read their reports, and won't bother to ask questions.
- **Make sure that you get the right kind of advisor for your trust.** Not all advisors specialize in all types of investments. You can find advisors for every type of investment and combination of types (balanced investments that produce income as well as capital gains, for example). If you're looking for income production but aren't too bothered if you don't see huge capital gains in the account, you want an advisor who specializes in *fixed income securities* (bonds). Perhaps the trust doesn't yet have an active income beneficiary, and all the income is accumulating in the trust. In that case, you may be more likely to want an advisor who specializes in *growth companies,* which usually pay a very small dividend (if they pay one at all) and concentrate on increasing the size and value of the company.
- **Don't limit yourself to one advisor.** You may need only one advisor, or you may want more than one. If the trust is large, you may not want to put all your eggs in one basket with one advisor. And if you sense you're not getting the service or results you require or want from any particular advisor, don't hesitate to take the trust away from him or her. Remember, it's not his or her money, so he or she has very little at stake (other than loss of fee income). You, on the other hand, have to answer to the income beneficiaries and the *remaindermen* (the people or organizations who receive whatever's left in the trust after the income beneficiary's interest ends).
- **Remain in close communication with the advisor.** Any investment advisor worth his or her salt sends monthly or quarterly reports. Read them carefully. Although he or she works for you, money often leads people to behave badly, and these advisors have access to lots of it. If something doesn't look quite right to you, such as fees that seem high or huge numbers of purchases and/or sales, often for very small numbers of shares of stock in the same companies, ask questions. If you're not absolutely satisfied with the answers, ask for an opinion from a professional you trust (perhaps an attorney, an accountant, an enrolled agent, or even another investment person such as a stockbroker) and have him or her give the report the hairy eyeball. If anything is fishy there, any of these people should be able to smell it.

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Holding and Diversifying Assets

As trustee, you're responsible for investing the trust property. Although you may have your hands tied by a trust instrument that dictates that you hold onto certain property the grantor has given to the trust, most trusts give the trustee investment control over at least some assets. Your job is to invest it conservatively but broadly, giving that principal a chance to grow. Depending on the powers given to you by the grantor under the terms of the trust instrument, how you go about your task is up to you.

For example, one of us once administered a trust (but, thank goodness, wasn't the trustee) that held a million or so shares of the family business. It just so happened that the family business was a very successful publicly traded corporation, and that those million shares produced a large enough dividend to keep the income beneficiary comfortable for his entire life. That said, though, by not selling those shares and investing in a broader way in the stock and bond markets, the trustee left himself open to all sorts of charges of *malfeasance* (trustee misconduct). Basically, the trustee hadn't done his job, and the result for the trust, the income beneficiary, and the remaindermen could have been disastrous if that family corporation had fallen on hard times, or even gone bankrupt. Think of Enron and its pension plan members, who were only invested in Enron stock.

This section explains the different types of assets that you may be responsible for as a trustee and, where appropriate, what you must do to ensure that they're diversified.

Stocks

Investing in the stock market is one of the most popular ways to get trust principal working for you and producing income for the trust's income beneficiaries. *Stocks* (sometimes referred to as *equities*), are ownership interests in corporations. As a partial owner in a corporation, the trust is entitled to a share in the corporate profits, which are paid as dividends (usually quarterly but sometimes as often as monthly or as infrequently as annually).



In order to diversify the trust's stocks, the trust needs to invest in a broad range of companies, covering all the major areas of the stock market: from manufacturing to transportation to all forms of medical services and products to commodities such as oil and gas. And in this increasingly international age, you don't want to focus only on U.S. companies; rather, consider casting your net worldwide. Some experts say that an adequately diverse portfolio should contain stocks in no fewer than 75 corporations; others raise that number to 140 or more. If you're investing a relatively small amount of money, you can

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circumvent the necessity of buying tiny amounts of stocks in so many companies by investing instead in one or more broad-based mutual funds, which themselves own shares in many, many corporations. Just be sure to read the *prospectuses* (the brochures that every fund has detailing the rules governing the fund and listing a sample investment portfolio in the fund) first, before you invest, so that you understand exactly what it is you're buying. Head to the section entitled, "Mutual funds," later in the chapter for more information.

You don't necessarily need to buy stock in corporations that pay regular dividends. Some very fine corporations never or only rarely pay any dividend. As trustee, you're on safe ground investing in a non-dividend paying corporation, provided you can see the potential for growth in that company. As a corporation's value grows, the trust (as a partial owner of that entity) is entitled to a share of that growth. As long as the trust continues to own shares, the corporation's increased value translates to an increased market value for the shares you own. When you sell those shares, the money you receive for them should exceed what you paid for them, giving you a capital gain.

Bonds

Bonds are pieces of loans, packaged by a corporation or a government as investment product. When you purchase a bond, you're purchasing a piece of someone else's debt. In exchange for the money you're indirectly lending, that debtor agrees to pay you interest. Bonds are sometimes referred to as *fixed-income securities*, because the income that they generate for the trust is tied to the stated interest rate on the bond. You'll receive no more interest than what's stated, and hopefully, no less.



When investing in bonds, you're typically looking to produce a steady stream of income for the income beneficiary. One of most effective ways to achieve that goal is by *laddering* the maturity dates of the bonds you buy so that bonds mature in sequence, rather than all at once. For example, you may buy one bond that matures in 2009, one in 2010, one in 2011, and so on. By laddering bond maturities, you cushion the income beneficiary from huge drops in his or her income at times when income rates plummet.



Different income beneficiaries have different needs. Some require as much income as you can squeeze out of the trust's principal; others want whatever income they receive to be tax exempt. Still others are best served by a combination of approaches. The most common types of bonds and what they can offer both the trust and the beneficiary are as follows:

- **Corporate:** Issued by corporations, these bonds generally carry some of the highest interest rates available. The interest earned is taxable at both the federal and state level.

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- **Foreign:** Other countries borrow money, too, and foreign bonds can be very attractive to investors. If you feel so inclined, or your investment advisor thinks that foreign bonds are a good, safe place for some of the trust's principal, you should consider sticking a toe in this water. What can complicate foreign bonds somewhat is that they're typically sold in foreign currencies (and pay interest that way, too). Although your brokerage can handle all the currency exchange issues, your return on investment isn't just dictated by the stated interest rate (which doesn't change) but also by currency exchange rates (which do fluctuate). Interest on foreign bonds is taxable at both the federal and state levels.
- **Municipal:** Issued by states, cities, and towns, these bonds carry lower interest rates because they're exempt from federal income tax, and depending on what state(s) the trust and trust beneficiary pay income tax to, they may also be state income tax free.
- **U.S. Government:** Not to be confused with U.S. Treasury obligations, U.S. Government bonds are the debts of U.S. governmental agencies, such as *GNMA* (U.S. Government National Mortgage Association, in case you were wondering). These bonds typically pay a slightly higher interest rate than U.S. Treasury obligations, but interest from them is income taxable at both the federal and state levels.
- **U.S. Treasury:** The safest of all safe investments, these bonds are backed by the full faith and credit of the United States Treasury. We're talking Fort Knox stuff here — if you can't sleep at night because you're worrying about how secure the trust's principal is, you don't get any safer than U.S. Treasury obligations. In exchange for lending money to the U.S. Treasury, it pays you interest and as an added bonus, the interest is tax exempt in every state (so you pay only federal income tax).



Just as you may not consider loaning money to your shifty Cousin Norman, you may not want to lend the trust's money to some corporations or municipalities with reputations for mishandling money or being perpetually in debt. How can you tell? If it seems too good to be true, it probably is; be very wary of bonds that promise extraordinarily high interest rates. Face it, if the corporation, city, or town could borrow money and pay less interest, wouldn't they do so? These very high interest rate bonds are sometimes referred to as *junk bonds* or *high-yield bonds*. If you're in a position where you need to generate a large amount of income for your income beneficiary, you may want to venture into this arena, but go very carefully. These bonds carry not only a high interest rate but also a high rate of default. Remember, if the bond issuer defaults on the loan, not only do you not get your interest payments, but you've also just lost your principal investment.

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If you're not sure about a bond you're considering purchasing, you may want to check that particular bond's *rating,* which is essentially a grade assigned to that bond by the rating agencies. The two major agencies, Standard & Poor's (S&P) and Moody's Investor Services, assign ratings when a bond is first issued and then periodically review their ratings based on how the borrower is doing financially. You can phone Moody's rating desk at 212-553-0377, or you can access Standard & Poor's ratings by going to `www.standardandpoors.com` and then clicking on "Ratings". For both services, you need the bond's identifying number, a nine-digit alphanumeric identifier called its *CUSIP Number,* in order to check a specific bond. Every publicly traded security has a CUSIP Number; it's listed on the face of the bond. If the broker holds the trust's securities, the CUSIP Number appears on the original purchase confirmation or on your monthly or quarterly statement.

Grasping basic bond terminology

Investing in bonds can be one of the safest and easiest ways to invest, yet many people shy away from these investments because they may not understand all the words used in their descriptions. How is it possible to know exactly what you're buying? Here's a short course in Bond Terminology 101.

All bond descriptions carry certain required information that can tell you a great deal about what you're buying. They should all have a *face amount*, which is nothing more than the amount of money the bond issuer promises to repay you when the bond matures. It also gives an *issue date,* or the date the loan was created, and a *maturity date*, or the date the loan will be repaid, plus the interest rate.

Bonds actually come in three varieties, based on how long you hold them. *Bills* are issued for a period of one year or less. *Notes* are issued for periods of less than ten years. *Bonds* are issued for periods of ten years or greater. Both bonds and notes are issued at their face value (you pay $100 for a $100 note) and pay interest semiannually based on the date of maturity, not the date of issue. Bills, on the other hand, are purchased at a discount (you pay $95 for a $100 bill), and only pay interest at maturity, when you receive the full face value of the bill.

Some bonds are *prerefunded*. Even though they're issued with a stated maturity date, the issuing authority has the option of paying off the loan early, at specified dates (the *prerefund dates*). Other bonds are *convertible*, which means the corporation may exchange them for its common or preferred stock at its own instigation. When corporations convert their bonds, bondholders always have the option to take cash rather than stock. Corporate bonds may also be *subordinate*, causing this particular bond issue to stand behind other debts of the corporation. In other words, if the corporation goes belly up, the subordinated bondholders don't get any of their money back until other corporate debts are paid first.

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Mutual funds

If buying individual stocks and/or bonds isn't your cup of tea, because you're unsure about what (and how much of any particular security) to buy, then you may want to consider investing the trust's money in a mutual fund. Diversification is the name of the game with mutual funds. A *mutual fund* is something like a buying club, where a bunch of like-minded investors (like you) pool their money, hire an advisor, and allow the advisor to invest the pooled cash in a way that's been determined by the investors. In exchange for the cash, the individual investors receive shares in the fund, not shares in the individual investments that are purchased and sold by the fund.

In fact, by their very nature, mutual funds are diverse and specialized. You can buy funds made up entirely of stocks or ones that only invest in bonds. You can purchase international funds, municipal bond funds, socially responsible and green funds, and funds that specialize in transportation companies. If you want, you can even buy a fund that only invests in so-called *sin stocks* like tobacco, alcohol, and weapons manufacturers.



When diversifying a trust's assets, mutual funds can be a very savvy trust investment. In exchange for the fees that every shareholder, either directly or indirectly, pays the fund manager, you receive expert advice as well as the potential for great diversification. In fact, you may become so caught up in picking and choosing mutual funds that you lose sight of your goal of diversifying the trust's principal and investing in all sectors of the economy. Before you invest in any mutual fund, check its prospectus very carefully to make sure that you understand what you're buying. We've both been involved with trusts that relied heavily on mutual fund investing, where the funds overlapped so significantly that the trustees hadn't really diversified the trust's assets at all, although they thought they had.



Just make sure that you're careful about the fund's fees when investing the trust's money in mutual funds. Funds are allowed to charge a variety of fees, including sales charges (sometimes referred to as a *load*), redemption fees, exchange fees, account fees, purchase fees, management fees, and/or distribution (sometimes called *service*) fees. You can reasonably expect to pay a fee for having someone invest your money for you, but you need to figure out upfront how much of a fee you're willing to pay. So-called *no-load* funds, which have no upfront or deferred sales charges, sound like a good deal, but make no mistake: Even no-load funds charge fees — you just may not be able to see them.

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Cash needs

As much as you want to maximize the income being earned by the trust's principal, you need to keep some cash on hand at all times to meet not only the trust's expected needs, like scheduled income distributions and quarterly estimated tax payments, but also unexpected expenses, such as unanticipated medical expenses for a beneficiary or larger-than-expected taxes for the trust. For example you never want to sell an investment right before the April 15 tax deadline in order to pay a tax bill because everyone else who owes taxes is facing the same tax deadline. Sales tend to flood the stock market around April 15 of every year, causing prices to plunge. Instead of selling when everyone else is, keep enough of a cushion of cash on hand in the trust to pay those bills when they roll around. And after you've paid your bills, make sure to replenish your cash stash — you never want to be caught short.



Cash on hand doesn't need to sit in an account earning nothing. Plenty of lower-risk money market accounts pay you something on your deposits, even though it's usually not enough to write home about. The money in the account remains very liquid, and you can pull it out at any time without a penalty when you need it. Every bank offers money market accounts, as do all mutual fund companies and stock brokerage firms. You'll have no difficulty opening one of these accounts wherever you keep your assets, although you may want to shop slightly farther afield. Some of the highest interest rates paid are offered by Internet banks, which have no local branches and very few employees, keeping their costs low.

Real estate

Real estate may not be a typical trust investment, but it's more common than you may think. Often, the grantor's residence may end up in the trust, either during lifetime or after the grantor's death. Or, the grantor may have held interests in either residential or commercial real estate, either outright, or through partnerships.

Dealing with real estate inside of a trust is really no different than dealing with it on a personal level, whether the trust owns the property the grantor's family is still living in or you're dealing with a trust version of Donald Trump with hotels, casinos, apartment houses, and shopping malls. The trust must pay the taxes, the insurance bill, and any other costs involved with the maintenance of that property.

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The expenses involved with maintaining the grantor's home aren't always clear cut. If the family residence remains in trust while the family is still in residence, part of your job is determining which expenses the trust should and shouldn't pay for. Mortgage payments, taxes, and insurance on the house itself clearly belong to you. You can also make a good case for lawn/garden care and trash and snow removal. If the house's contents are trust property, you need to pick up that insurance tab as well. But be cautious about many of the other costs associated with running a house, such as utility payments and the housecleaner. Discuss with the family precisely what items the trust is responsible for. Take into consideration what you think the grantor's purpose was in placing the house into trust, and act accordingly. Failing to have a stated plan in place may leave you in the unenviable position of rejecting reimbursement for food, medical care, or even bills to have the dog groomed. Believe it or not, one of us had a trust beneficiary who steadfastly maintained that because the trust undertook to pay the cleaners and the dog's hair increased the amount of cleaning to be done, the grooming bills actually should be paid by the trust.

Although the rules for owning real estate, including buying and selling, are the same for trusts as they are for individuals, two exceptions exist. Although individuals are entitled to a $250,000 capital gains exclusion for the sale of a personal residence (provided they've owned the house for at least two years and used it as a personal residence for two out of the last five years), trusts aren't. On the other hand, if that same residence is sold at a loss, the trust is allowed to claim the loss on **Schedule D** of the trust's **Form 1041** because the house isn't the trust's personal residence.

Small business stocks

Whether a trust receives *small business stock* (stock from a closely held or non-publicly traded corporation) during the grantor's lifetime or as part of the decedent's estate rolled into the trust after death, you may find yourself holding a substantial interest in a small business on behalf of the trust. The trust's grantor has hopefully prepared you for the receipt of this stock. Perhaps the trust's share of the stock is part of the greater plan to transfer ownership to the next generation. Or you may have instructions to sell the stock (presumably, in this case, because the grantor has buyers lined up and waiting).



If you, as trustee, find yourself holding shares in a small business, you're not only allowed to participate in the business, but you're also somewhat required to. Even if you don't want to be involved in the day-to-day running, don't be shy about asking to see financial reports and any other information the other owners may have regarding the company. Remember, one of your duties as trustee is to protect and conserve the assets of the trust. Even if you're not in a position to man the store, be an active player in what goes on behind the scenes. Otherwise, you'll have a difficult time justifying your care of the trust assets to the beneficiaries and/or remaindermen should the company go belly up.

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If the company in question is an S Corporation, be sure that the trust is eligible to be an S Corporation shareholder. Check out Chapter 3 for descriptions of which trusts qualify either as a qualifying S Corporation shareholder (QSST) or as an electing small business trust (ESBT). And if you're not sure, seek advice. Making a mistake here may have disastrous consequences not only for the trust but also for the corporation.

Going Green in a Trust

As trustee, you have the choice of investments. Even though many individuals are satisfied with selecting investments based purely on the balance sheets and potential for income generation of the companies involved, many trustees are starting to match their investment strategy to their, the grantor's, and, in some cases, the beneficiary's, personal philosophy. The result, *socially responsible investing*, is becoming more and more prevalent across all sectors of the investment community, and an increasing number of options are available to you accordingly.



Although you're allowed to do whatever you want with your own money, you must invest the trust's principal with a profit motive in mind. Even though no one can ever guarantee that an investment will provide *x* amount of income or increase in price by *y*, investing always carries the presumption of making money. Remember, so long as a socially responsible corporation or mutual fund can show that it's acting to produce a profit, you're okay in putting trust money there. But if the company is merely concerned with doing good in the world and not with producing profits for its shareholders, you're required to keep your trustee hands in your trustee pockets no matter how much you want to applaud its good work.

Socially responsible investing has been around for a long time in this country, but it's really become popular only since the late 1980s. As a result of the increased interest, you can now invest in socially responsible mutual funds. Many major mutual fund companies offer them alongside all their other funds; a couple of companies offer only socially responsible funds. The following sections highlight ways you can invest the trust's money in a socially conscious and politically aware way.

Socially conscious

Investing used to be so straightforward. In order to create a balanced portfolio, you purchased *blue-chip* stocks (stocks in well-regarded, stable companies with good records of earnings and price stability) or all the stocks listed on the Standard and Poor's index. Now, of course, it's not enough to buy what everyone else has been buying for generations. Today, if you want to be socially responsible and conscious, you also need to look closely at each

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corporation's hiring practices, treatment of their employees, environmental impact (and whether that's improving), and kinds of goods produced. For example, is the company manufacturing more garbage for landfills, or are they using an environmentally sustainable model in production? In fact, in order to be a truly socially conscious investor, you need to study far more than the balance sheet — you need to check out the corporate philosophy and its implementation.



Socially conscious investing isn't an easy matter. No corporation is going to come up trumps in every category you may be concerned with, and if you're interested only in buying ones that do, your potential list of corporations is going to be very short indeed. Instead, in this oh-so-imperfect world you may want to create your own set of criteria, focusing on those areas of social responsibility you are and aren't willing to compromise on. So you may find a company that promotes women at the same rate as men but hasn't reached energy sustainability just yet. Or you may find the (almost) perfect corporation, and then discover buried in its annual report the fact that it invests its excess cash in the stock of a corporation you despise. Remember, no corporation is perfectly conscious — perfect consciousness is a Zen concept that just doesn't translate very well to the corporate boardroom.

Politically aware

In addition to being socially conscious, many investors are also trying to push one political agenda over another in their choices of investments. There's some proof that this strategy works — who can deny that South Africa is a very different place today because investors deserted South African companies as an attempt to force change in that country? At the same time, Cuba is very much the same place today despite sanctions, so the strategy isn't foolproof.

No laws prohibit buying or boycotting companies based on the countries where they're located or companies whose stated business purpose supports one political point of view. So long as you, as trustee, are sufficiently convinced that a company has a solid business plan and all the tools in place to turn a profit and add to the trust's bottom line, that company represents a valid investment for the trust. The fact that you have the ability to further your own political agenda at the same time is kind of a nice side benefit.

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Looking to the Beneficiaries' Needs

If all that were involved in investing trust principal were choosing the investments and then seeing how well they did, anyone could be a trustee. However, being a trustee requires much more. You've been chosen because the grantor trusted that you'd be able to determine exactly what the beneficiaries need at any given time (and how best to make sure that they receive it), while at the same time balancing the desires of the remaindermen to have something at the end of the trust period.

Beneficiaries' needs change over time, and trust investments need to change in relation to them. As the trustee, you have to determine what the trust must do in order to meet those needs. You need to know when to switch investments in order to produce more income, and when you should tailor them to produce less income. It's sometimes a balancing act worthy of the Flying Wallendas — only now it's you on the high wire.

Don't worry though. You don't have to do it all on your own. Remember, you may have quite a bit of guidance lurking in the trust instrument itself, with specific instructions as to when you should make certain distributions and other, less specific wording, regarding where your discretionary powers lie. And don't forget your investment advisor (check out the earlier section "Using Investment Advisors Effectively"), who can help ensure that your investments meet the beneficiaries' needs. You also need to keep the following pieces of information in mind about the beneficiary.

Age

As trustee, you need to judge when beneficiary payments are useful, and when they're unnecessary. Even if the trust has a mandatory income beneficiary, you can still limit the distributions to that beneficiary by limiting the amount of income earned by the trust. Many trusts are invested primarily in non-income-bearing investments for that very reason. At the same time, you can select high-income-bearing investments to benefit a beneficiary who really needs the income from the trust to pay for living (or other) expenses. For example, a young child who is a trust beneficiary likely needs little from the trust, especially if his or her parents are still alive and are able to provide life's necessities. As that same child begins college, he or she may look to the trust to pay for some or all higher educational expenses. Or a working adult may require little from the trust now, but those needs may increase after retirement.

Although we don't advocate treating trust beneficiaries like you would your own children, it often feels like that with regard to money issues. The very items that concern you when your children are growing are the ones that factor into your decisions as trustee.

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Purpose of trust

Grantors often establish trusts for very specific reasons — to pay for college, to provide money to make that first home purchase, or to provide a safety net for someone the grantor isn't sure can completely provide for himself or herself. If you're a trustee of such a trust, you need to read the instrument very carefully to make certain that you know why the trust exists in the first place and then create a plan that answers that need. The following sections describe some common reasons grantors create trusts.

Trusts that distribute income currently

Very often, grantors create trusts to provide a steady stream of income to one or more beneficiaries, year in and year out. The beneficiaries who rely on this income look to you to make sure that they continue to have enough to live on, so you have to make sure that the trust generates not only enough income this year but also next year and ten years down the road. The only way you're going to be able to keep pace with inflation is to make sure that the trust's principal grows.



Adding difficulty to an already complex task is that trust beneficiaries often require more than just the income in order to live, and you may feel you need to make some principal distributions so someone you feel responsible for can pay the rent. All we can say is this: Before you make a principal distribution to the beneficiaries, consider all your options. Making principal distributions can be a slippery slope, and reducing the amount of available principal isn't a smart way to increase the income for future years. However, depending on the terms of the trust instrument, you may have the discretion to do so, and sometimes principal distributions aren't only appropriate but are also what the grantor would have wanted. Also keep in mind that income beneficiaries have a nasty habit of becoming used to higher payments. After they start receiving them, they expect them to continue. Income beneficiaries not only won't understand your explanation of the difference between income and principal, but they also won't want to understand.

Trusts that are age-based

Many trusts are created to behave one way while the beneficiary is one age and completely differently as that beneficiary ages. If you're trustee of such a trust, make a calendar of when your beneficiary hits those ages.

An age-based trust is known as an *accumulation trust* during the early stages because it doesn't make distributions while the beneficiary is young and therefore accumulates income. You want to invest the trust that's accumulating income very differently than one where the beneficiary depends on regular income distributions (such as a currently distributing income

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trust, described in the preceding section). An accumulation trust is typically invested in a way that minimizes the trust's income tax hit. Trusts, like individuals, pay a graduated income tax; however, a trust's run through the various tax brackets happens a lot sooner than an individual's, and a trust can be paying the top tax rate with just a little more than $10,000 of ordinary income. Ouch!



So if your trust is still in the accumulation stage, investing in stocks that pay small dividends is a popular strategy because it limits the amount of taxable income while still allowing the value of the trust to grow. However, the trade-off you should expect from a stock that pays a small dividend, or even no dividend at all, is that the market price of that stock should grow substantially because the company is plowing its profits back into the business rather than paying them out to shareholders. If you fail to see growth over time, don't hesitate to sell the stock, even if you sell it for less than you purchased it for. Everyone makes mistakes sometimes; better to realize that you've made one and get out than to hang on forever, waiting for the company to turn around. Check out *Stock Investing For Dummies,* 2nd Edition, by Paul Mladjenovic (Wiley), for the nuts and bolts of knowing when to get out of a bad investment.

As the beneficiary ages, and the trust begins to make distributions, you're now free to shift the investments to ones that produce as much, or as little, income as you think it wise to give the beneficiary. After the beneficiary is receiving income from the trust, the tax liability for that income is paid by the beneficiary, not by the trust.

Spendthrift trusts

One of the most popular reasons a grantor creates a trust is because he or she doesn't think that the beneficiary of that trust is able to handle large sums of money. A *spendthrift trust* is designed to deal with that situation, giving absolute control of the money to the trustee, who then must make the decisions about how much money to distribute and how often.

Spendthrift trusts are absolutely discretionary, in that the trustee has total control over the distributions; the only requirement is that you keep the best interest of the beneficiary front and center at all times. If you're the trustee, you may distribute income or principal if in your best judgment it benefits the beneficiary, even if the payments aren't made directly to the beneficiary. For example, if your beneficiary in spendthrift trusts has medical issues that require care, you may opt to pay the beneficiary's health insurance premiums, doctor and pharmacy bills, or even hospital and nursing home care bills directly to those organizations instead of giving the money to the beneficiary to do so.

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Paying the Trust's Expenses

In addition to making payments to the beneficiaries, as trustee, you're also responsible for paying the expenses you incur in administering the trust. The following sections outline the primary expenses you'll have and what you need to remember when paying them.

Trustees' fees

If you're not a professional trustee (or acting for an institutional one), chances are good that you agreed to be trustee out of the goodness of your heart, and you'd really do this work for nothing. Still, even if you're a family trustee closely related to the grantor and the beneficiaries, you've probably already figured out that administering a trust can sometimes be a time eater. You're not unreasonable to want to get paid for that time. And that's all a *trustee's fee* is: the amount the trust pays to compensate the trustee for his or her time.

There is no set trustee's fee. You can choose to base it on a small percentage of the market value of the assets plus a percentage of the income earned by the trust, or you may opt to calculate the number of hours you spend and bill by the hour. You may even charge a flat fee, which is more like an *honorarium* (basically, a professional thank-you gift). What you may not do is overcharge. How much is too much? Like the Supreme Court standard for pornography, people tend to know it when they see it. We prefer to think of it as the stink test. If either of us sees a fee and her nose starts to twitch, she's going to be looking for an explanation of that fee pretty quickly.

Trustee fees are an income tax deduction for the trust but taxable income to you. You must declare these fees on your **Form 1040**, where you place them on line 21, Other Income. If you're a professional trustee (an attorney, accountant, enrolled agent, or other financial professional), this income is also subject to Self-Employment Tax; otherwise, it's income taxable only.



Trustee fees are typically paid both from principal and income so as not to burden either side unduly. After all, your job is to look after both of their interests; it's only fair that both sides help to foot your bill.

Investment advice



Investment advice is deductible to the trust minus that pesky 2 percent haircut that miscellaneous itemized deductions are subject to. Chapter 18 describes how to calculate the deduction in all its hairy details.

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Accounting fees

Unless you're preparing Form 1041 by yourself, you also have to pay accounting or tax preparation fees. You may choose to pay these from income or principal, or a combination of the two. We usually pay them from income, but that's just our habit. Accounting fees in a trust are usually charged on an hourly basis or on the complexity of the returns being prepared, and are fully deductible — no haircut here.

Taxes

State and local income taxes, real estate taxes, personal property taxes — these bills are all deductible if paid by the trust on trust obligations. So, if the trust owns real estate, it gets to deduct those taxes. If, on the other hand, the trust pays the real estate taxes on property owned by the income beneficiary, the trust has actually made a distribution to the beneficiary.

- If the trust is only paying a capital gains tax, you pay that from principal. (Remember, capital gains remain in the trust and aren't distributed to the income beneficiary.)
- If the trust is accumulating income, you pay the entire tax from principal because the accumulated income is transferred to principal at the end of each year and becomes part of the principal.
- On occasion, when you don't transfer accumulated income to principal, you pay taxes on the ordinary income of the trust from the income side, and the capital gains taxes from the principal side. For example, one of us works with a trust where the accumulated income is payable to the income beneficiary's estate when he dies. In this case, paying the taxes owed on income that would be payable to the beneficiary (if he chose to take it) from the income side, and the taxes on the capital gains (to which the beneficiary isn't entitled) from the principal side isn't only advisable, it's mandatory.

To the extent that income is available in the trust to pass out to a beneficiary (for an expense such as the real estate taxes mentioned earlier), that tax payment becomes an income distribution and the beneficiary will receive a **Schedule K-1** from the trust in due course. Chapter 19 explains all you need to know about the K-1 and how items from the trust's checkbook can eventually end up on the beneficiary's tax return. It's a pretty nifty trick.



Unlike individuals, who may deduct state sales taxes rather than state income taxes (handy in states with no income tax), state sales tax deductions aren't available for trusts. After all, trusts don't buy anything except for services, and those services typically aren't subject to sales tax.

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Chapter 13

Paying Trust Beneficiaries

In This Chapter

- Establishing who, exactly, are the trust's beneficiaries (and getting the info you need from them)
- Setting up the distribution schedule
- Ensuring that you make the proper distributions at the proper times
- Handling beneficiaries who ask for or need unscheduled distributions

If stashing money away in a trust fund is great, figuring out how to invest it so it makes money is even better. Still, going through all this trouble is basically pointless unless you do it to benefit someone else: the trust beneficiary. The *trust beneficiary* is the person or institution who's named in the trust instrument to receive income and/or principal from the trust.

In this chapter, we explain how, when, and why you make distributions over the lifetime of the trust to the trust beneficiary or beneficiaries. We give you the lowdown on the information you need from and about the beneficiaries before you can write that first check, and how to determine whether you should ever pay more than the absolute minimum the trust instrument directs you to pay. And when it's time to completely discharge your duty as trustee, we tell you what you need to know to make those final distributions.

Notifying Trust Beneficiaries

Even though some trust beneficiaries, such as wives or children, know well in advance of that first distribution that a trust has been established for their benefit, we've noticed that *grantors* (the person who establishes the trust) often fail to tell named beneficiaries that trusts exist for their benefit. Sometimes it's because they want to encourage that person to strive and to achieve without the knowledge that there's a safety net securely fastened beneath them; other times, the grantor doesn't want to discuss his or her own mortality with a child or grandchild. Whatever the reason, it often falls to you, the trustee, to inform the beneficiaries of the existence of the trust and the fact that they'll reap some benefit from it.

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Notifying a beneficiary doesn't have a formal steps to follow; basically it's really up to you to figure out how best to notify him or her. If you know the person, a telephone call can accomplish the task with very little fuss and bother, and gives the beneficiary an immediate chance to ask questions. If you're not acquainted with the beneficiary, a simple letter suffices, advising him or her of the existence of the trust, and that he or she is a named beneficiary. Include all of your contact info (telephone, e-mail and snail mail), and urge the beneficiary to contact you at his or her earliest convenience. Remember, you won't be able to begin making distributions until you've set up a reliable form of communication with the beneficiary.

When you make contact with the beneficiaries, this section points out the necessary info you need to retrieve from them.

Obtaining addresses and Social Security Numbers

After you notify the beneficiary, you need to obtain his or her address and Social Security Number. Beneficiary payments may, and probably will, contain elements of taxable income. Because he or she must pay the tax on that income, you shouldn't make any payments without obtaining tax reporting information upfront.



Trust beneficiaries often plead poverty or extraordinary circumstances, especially when waiting for that first trust distribution. Resist the temptation — keep your hands on the cash and don't make any payments until the beneficiary coughs up his or her address and Social Security Number. If you pay before you have the information you need, you may still be waiting for it when you sit down to prepare the trust's tax returns many months later.

Of course, you can't force a beneficiary to give you his or her Social Security Number, and you can't withhold payments indefinitely. If you find yourself in a position where you made distributions without first receiving the beneficiary's Social Security Number, you may be forced to file a tax return for the trust (Form 1041) that's missing this required piece of information. File the return anyway, making sure that you include as much information, such as the beneficiary's address, as you can on Schedule K-1 (see Chapter 19). Provided you can show the IRS you made a concerted attempt to obtain the information, you should be off the hook for filing an incomplete return.

Verifying dates of birth

Knowing the beneficiary's birth date is important, and not just so you can send a card every year. Many trusts are created with payout schedules based on ages; as trustee, you need to know when the beneficiary has reached a

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certain age and adjust the mandatory payments accordingly. Obtaining third-party verification of a birth date isn't necessary. Usually, beneficiaries are more than happy to provide you with their correct date of birth.



Knowing the trust beneficiary's age is important because it helps you choose appropriate investments, allowing you to minimize certain types of income at a time when the beneficiary is in a higher tax bracket. If a beneficiary's under the age of 19 (or 24, if a college student), he or she may be subject to the so-called *Kiddie Tax* on investment income, which essentially charges tax on the child's income at his or her parents' highest applicable rate. Unfortunately, investment income is exactly what a trust produces, so all income received from a trust may be subject to this additional tax. After the beneficiary has left college and is earning, you can then change the investment mix to one that produces more income taxed at a lower rate.

For information on how to calculate the Kiddie Tax, check out the latest version of *Taxes For Dummies* by Eric Tyson, Margaret Atkins Munro, and David J. Silverman (Wiley).

Determining Scheduled Distributions

Although not every trust makes distributions to its beneficiaries on a continuing basis (either monthly, quarterly, or annually), all trusts are required to make distributions at some point in their existence, even if the only distribution made is the one that terminates the trust. As trustee, you have to figure out what that schedule should be and make sure that distribution dates are calendared somewhere. It doesn't matter whether you write them on a chalkboard on the wall, enter them into your computer database, or arrange to have reminders telepathically sent on the appropriate dates. What does matter is that you have a plan in place to be certain that distributions required by the trust instrument are made when they're due to be made. If you're not sure where to begin when making distributions, this section helps ensure that you know how much to pay and when.

Figuring out how much to pay

When trying to determine how much to pay beneficiaries, you first want to look at the trust instrument for direction:

- **Fixed amount distributions:** Sometimes, the trust instrument instructs you to pay a set dollar amount on a certain date. One of us, for example, prepares the tax returns for a family of trusts a grandmother set up for her grandchildren. Although Grandma is long gone, each of her grandchildren still receives $1,000 each and every year as a birthday gift.

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- **5/5 provision:** Often, a trust for the benefit of a surviving spouse contains a so-called *5/5 provision*, where the surviving spouse may request a distribution of either 5 percent of the assets or $5,000 annually, whichever is greater.
- **Trust accounting income:** Far more usual than the fixed amount distribution, though, is a distribution that's based on the net income of the trust, or *trust accounting income*. The trust may require all income to be distributed annually, quarterly, or even monthly. If the instrument contains this requirement, you need to be sure that the payments are made within a reasonable amount of time after the due date. You're allowed to be a bit late — sometimes you can't possibly calculate the actual income until after the actual date you should have sent out a check. But you really should try to make that distribution as soon as you possibly can. Remember, in accepting the role of trustee, you've agreed to abide by the terms of the trust; failure to do so may give the beneficiary grounds to try to have you removed.
- **Discretionary distributions:** Although it's by far more frequent for a beneficiary to come to you, hat in hand, to ask for more money (see the section "When Beneficiaries Request More Money: Paying Out Extra Distributions" later in this chapter), sometimes you may see a need that the beneficiary doesn't. He or she may be struggling financially but is too proud to ask help. Or the beneficiary may have some medical problems that an injection of cash can help alleviate. Most trusts provide you, the trustee, with the discretion to make additional, unscheduled distributions. Usually, the terms of the trust limit these discretions to issues of health or education. Sometimes, though, the trustee's discretionary powers are extremely broad, and the trust instrument contains language to the effect that the trustee may act as he or she sees fit. Read your instrument closely to see how much discretion you're allowed. In the case of discretionary distributions, you're not limited to distributing only income, but may also make principal distributions if you, in your estimation, feel that they're warranted.

Calculating Trust Accounting Income

Trust Accounting Income, or *TAI* for short, is the formula that determines how much income is available to be distributed to the income beneficiary. You calculate it by adding together all items of income and then subtracting all expenses attributable to income. Here's an example. The Albatross Trust owns principal assets that include both taxable and tax-exempt bonds, dividend-paying stocks, and an interest in a shopping mall. In addition to the trustee fees the trustee pays herself, she also pays an investment advisor to assist her in investing in the stock and bond markets and an enrolled agent to prepare the trust's income tax returns.

To arrive at TAI, the trustee of the Albatross Trust adds up all the interest, dividends, and rental income earned, even if some of that income may be tax exempt on the trust's income tax return. Then she subtracts whatever share

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of trustee, investment advice, and accounting fees she actually pays from the income earned (she may, and probably does, pay a portion of all these fees from the principal side of the account). In addition, she also subtracts any income taxes paid from the income side of the trust and any miscellaneous expenses (even if they're not tax deductible).

In Table 13-1, you see how the Albatross Trust's trustee assigns items of income between the income and principal sides of the trust, and also how she allocates the fees charged to the trust. Remember, although the rules for allocating income are fairly rigid, the trustee may be much more flexible and use her judgment in allocating fees and expenses provided, however, that the allocation is a reasonable one and that it doesn't unduly favor either the income beneficiaries or the *principal remaindermen* (the people who get the assets in the trust when the trust terminates).

Table 13-1 Calculating TAI

Description	*Income*	*Principal*
Income received		
Ordinary dividends	$1,000	
Taxable interest	$10,000	
Tax-exempt interest	$2,000	
Rents and royalties	$600	
Long-term capital gain distributions		$500
Short-term capital gains		$1,000
Long-term capital gains		$1,500
Total Income	**$13,600**	**$3,000**
Deductions		
Trustee's fee	($500.00)	($500.00)
Tax preparation fee	($250.00)	($125.00)
Investment advice	($1,000.00)	($1,000.00)
Federal income taxes paid		($500.00)
State income taxes paid	($200.00)	($150.00)
Total deductions	**($1,950.00)**	**($2,275.00)**
Net additions to principal		**$725.00**
Trust Accounting Income	**$11,650.00**	

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If you're required to pass out all the income in the trust, calculating TAI gives you the exact number you need to pay to the beneficiary. If, on the other hand, you're directed to pay out a set amount, nothing at all, or you only make distributions at your discretion, calculating TAI is something you need only do when preparing your annual **Form 1041, U.S. Income Tax Return for Estates and Trusts;** it doesn't have any impact on the distributions you do make. Chapter 18 tells you how to complete this tax return.



We're noticing that a lot more trusts are investing in foreign securities, and income earned from foreign securities often means paying foreign taxes. Although the U.S. has tax treaties with most of these countries that entitle you to claim a refund for these foreign taxes you're paying, in most cases the amounts you're chasing after don't warrant the additional work required to collect the refunds. Instead, you may choose to claim a Foreign Tax Credit on Form 1116, which you then attach to your Form 1041. Foreign taxes paid are not income taxes chargeable to the trust. If you're distributing the income from the trust, you're probably also distributing the foreign tax credit to the trust's beneficiary. If this is your situation, don't subtract foreign taxes paid when calculating TAI. In fact, by passing the credit through to your beneficiary, you're actually making a distribution to him or her that should be included in TAI.

Making distributions after the end of the year (Section 663(b))

What's left after adding together income and subtracting all the income-related expenses is the trust's TAI. If you're administering a trust that requires all, or a percentage of, income to be paid out currently, you need to calculate TAI before you can make distributions. If you want to make distributions more frequently than annually, you can make an educated guess for the first three quarters of every year. Then, in the fourth quarter, you have to calculate TAI for the entire year and adjust the fourth quarter distribution accordingly.



Of course, because the fourth quarter doesn't end until December 31, it's basically impossible to have all the information you need before the end of the calendar year. The IRS understands (some of those agents have trusts, too), and accordingly gives you 65 days after the end of the calendar year to make your calculation and pay that final distribution. If you use this extra time to make a year end distribution, be sure to tick the box on question 6 at the bottom of page 2 of Form 1041. You've just made a Section 663(b) election for the trust.

Creating a payment schedule



How can you be certain that you'll have cash in the account when you need it? Simple. Just develop a payment schedule that ensures that the trust will have enough money when you need it. Keep the following pointers in mind to help you:

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- **Project what your income and expenses will be throughout the year, and when you expect to be making payments for fees and expenses in the trust.** If the income generated by the trust is uneven, so that you receive large amounts in one or two months but very little the rest of the year, be sure to schedule your fees and expenses payments after you've received the bulk of the trust's income. Only after those payments have been made should you make payments to the income beneficiary. So, if you receive large payments in May and November but not much else for the rest of the year, for example, you should schedule your fee and expense payments for early June and December, and then you can safely pay whatever income is remaining to the beneficiary toward the end of June and December. You can create this schedule for your trust on a slip of paper or on a computer spreadsheet program.
- **Make sure that you pay all other obligations before you ever write a check to the beneficiary.** Income from interest and dividends posts most heavily into accounts around the 1st of each month, and most tax payments are due on the 15th. Service providers almost always bill you on or about the first of the month. After the trust pays these obligations, then you can arrange to make beneficiary payments, usually toward the very end of the month or quarter.
- **Most important, don't ever leave yourself short at tax time.** Although accountants and attorneys may not be happy about having to wait for payment, and income beneficiaries may plead poverty endlessly in your ear, no one has the same ability to turn your life into a miserable wasteland as the IRS and the state tax authorities have. In addition to tacking on penalties and interest for late payment or late filing, the IRS can also *levy*, or reach in and grab the taxes due directly from the trust's bank or brokerage account. And good luck pleading hardship — this is a trust, after all, and as far as the IRS is concerned, anyone with the wherewithal to form a trust can't be suffering financially that much!

Distributing When the Beneficiary Reaches a Specific Age

Trusts are often designed to keep large sums of money out of the hands of people who may not be able to handle them. Of course, people change over time, and most of us become more responsible the older we get. In recognition of this fact, many trusts contain provisions to distribute income and/or principal of the trust to the trust's beneficiary at certain ages. The following are two of the most common scenarios:

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- **Income required:** Trusts often don't begin mandating distributions of income to the beneficiary until he or she reaches a certain age. On occasion, distributions may begin as young as age 18. More frequently, they start at age 21 or even age 25. Rarely (although it does happen), the grantor may delay the start of mandatory income distributions as late as age 30.
- **Principal distributions:** Because (in most states) trusts aren't allowed to exist forever, trusts usually have a termination scenario spelled out. In many cases, the trust terminates when the income beneficiary dies. In other cases, where money is held in trust for a beneficiary who the grantor may not feel is mature enough to handle large sums at the time the trust is created, the principal distributes to that beneficiary as he or she attains certain ages. Depending on the grantor's wishes, distribution ages may start as early as age 21; however, age 25 or even age 30 is far more common as a starting point. Principal is commonly distributed in shares at five-year intervals, so that a beneficiary would receive, for example, one-third of the principal value at age 25, one-half of the remaining value at age 30, and the balance of the trust principal at age 35. These distributions come in two varieties:
  - **Cash:** A cash distribution is by far the easiest type of distribution to make because all you need do is calculate the amount of the distribution required and then write a check. If you know when the distribution is due to be made (and you should know because you placed the date on your calendar when you began administering the trust), you may accumulate a war chest of cash and money-market-type investments, if you're not making a total distribution of the trust's assets.
  - **Division of assets:** If the trust has more than one beneficiary who is entitled to a share of the principal assets, you may have to distribute assets rather than cash, especially when the trust terminates. In this case, be certain that each beneficiary entitled to a share gets a share of the fair market value on the date of termination. In the case of *marketable securities*, or those assets which can be bought and sold on the major stock, bond, or commodities exchanges, obtaining market values on that date is easy (check out Chapter 7 for a quick refresher on how to value assets) and divvy up the assets accordingly. With privately held assets, such as a business or real estate, you need to obtain independent appraisals before making distributions. Be sure that each beneficiary receives an equally valued share, even though each may receive substantially different assets.

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When Beneficiaries Request More Money: Paying Out Extra Distributions

The trust is now up and running. The principal is invested and generating income, you've figured out how to pay everyone who needs to be paid and still have money at the end of the month or quarter to give something to the income beneficiary, and all seems well in your world.

But wait! The phone rings — the beneficiary has just decided to return to school, buy a house, start a business, have that little medical procedure done that isn't covered by insurance, or to invest in a foolproof way to turn straw into gold. As long as we've been in this business, you'd think we'd heard all the excuses for wanting more money. We've posted bail for clients and even paid for them to sue us, the trustees.

In fact, the only certainty in administering a trust is that, as much money as you manage to pay out to the income beneficiaries that's mandated by the terms of the trust, they'll always want more. How much more varies, as does the worthiness of the requests. If you do receive requests for extra distributions from the beneficiaries, your job as trustee is to shovel through the rationalizations before handing out any money. You must determine

- **Does the request have merit?** Not only are you not required to give in to each and every demand from the beneficiary, but you also really shouldn't. Not every request deserves a positive response.
- **Would the grantor have given the money for this purpose?** You need to put yourself in the grantor's shoes and make that determination. If, for example, the grantor wanted to encourage home ownership, and the beneficiary is asking for help with a down payment, your answer is clear. If, on the other hand, the beneficiary is asking for money to attend bartending school and the donor was a fervent teetotaler, you may want to think twice.
- **If you make this extra distribution, how will it affect the ongoing purpose of the trust?** If the purpose of the trust is to provide a safety cushion for an income beneficiary who is relying on that income to live, and depleting the principal of the trust in order to make this discretionary distribution would severely impact the trust's ability to provide that ongoing financial cushion, you may want to think twice, or even three times, before writing that check. Be willing to ask for more informa-

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tion regarding how the beneficiary plans to use this distribution. For example, if the distribution would enable the beneficiary to reduce living expenses (perhaps by purchasing a house for cash rather than requiring a mortgage), the loss of future income may be more than offset by the long-term reduction in the beneficiary's expenses.

- **Are you being asked to make a distribution to a spendthrift beneficiary?** In our experience, a fair number of trust beneficiaries are only trust beneficiaries because money runs through their fingers like water. When parents and grandparents place inheritances in trust for such heirs, it's usually for the sole purpose of preventing them from frittering away the money. Unfortunately, because trusts for spendthrifts tend to restrict access to any of the money except at the trustee's discretion, a beneficiary of one of these trusts can almost be guaranteed to live in your pocket, constantly asking for money for this, that, or the other. Weigh these requests carefully; some have merit, but many don't. As we show in the section "Making the Decision to Distribute Discretionally: Eyeing the Trust's Terms" you have to place yourself in the grantor's shoes to make that determination. And, should you choose to make a distribution, be certain to obtain proof that the money is being used for the purpose intended. Depending on the beneficiary, you may want to pay the beneficiary's bills directly instead of giving the money to the beneficiary and relying on him or her to make those payments.



If you're the trustee of a spendthrift trust, you want to carefully document all your dealings with the beneficiary. If possible, all requests that come directly from the beneficiary should come in writing so that you can see, on paper, the scope of the request. And, if the beneficiary is requesting money to pay a specific bill or fund a project, don't rely only on the beneficiary's say-so, but request a copy of any third-party documentation, such as the bill that needs to be paid. Don't hesitate to contact that third party directly for verification.



And, if you choose not to make the distribution, be sure to notify the beneficiary, in writing, of your decision, referencing the part of the trust instrument that gives you the discretion to say no. In our experience, although many beneficiaries of spendthrift trusts are absolutely wonderful individuals who are merely challenged by money, some are merely looking for an excuse to make your life miserable. By keeping a well-documented paper trail, you protect yourself from having your past decisions rebound on you.

Making the Decision to Distribute Discretionally: Eyeing the Trust's Terms

Very often, trust instruments give you, the trustee, a great deal of guidance as to what sorts of discretionary distributions the grantor thought you may be asked to make. Some of these so-called discretionary powers are quite

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narrow, but others leave you with almost completely unfettered range, both with regard to requests you receive from the beneficiary as well as those needs of the beneficiary that you, yourself, identify. This section provides some guidance to help you make these decisions.

Ensuring health and well-being

Among the most popular of discretionary power standards is one that allows the trustee to make payments to ensure the health and well-being of the trust's beneficiaries. Usually, this power extends the class of beneficiaries well beyond the stated income beneficiary: that person's spouse, children, grandchildren, or other issue. And, unless explicitly stated in the trust instrument, it's not just to cover medical expenses. Instead, the health and well-being standard can be used, if the trustee chooses to interpret it as such, to provide a wide variety of extras to the beneficiaries. In addition to paying doctors' bills and providing health insurance for those who don't have any, the trustee may also determine that vacations, ballet lessons, summer camps, and other such items add to the beneficiaries' general health and well-being.

Of course, although the standard is broad, it's not unlimited. Although most trustees would probably agree that replacing an aging, mold-infested residence with something that provided a cleaner environment meets the health and well-being standard, they probably would also agree that replacing one adequate residence with another, larger one doesn't.

Paying for education

Saving money for education in a trust can be a very effective way to pay for college, and many people use trusts for this purpose. Saving for education inside a trust allows much greater flexibility when the time comes to pay for that education — and, should the child or grandchild named as beneficiary receive merit scholarships or choose not to go to college, the money can easily be used for other purposes at other times.



If the trust you're administering allows you discretion to make distributions for education, you should be aware that education isn't limited only to postsecondary schools. You may also use trust monies to pay for private primary and secondary education, for supplemental educational programs, for summer camps that have some sort of educational focus (we know of several trust beneficiaries who've attended summer music camps thanks to discretionary trust distributions), for tutoring, or even to buy a computer. In fact, if you think the request is reasonable, and you can rationalize that it furthers the beneficiary's education in some way, you're most likely on safe ground in making that distribution.

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Buying a home

Very few trust instruments include any specific language allowing you to make a distribution to a beneficiary so that he or she can purchase a house. At the same time, very few trust instruments explicitly prohibit you from making distributions either for down payments or for the total purchase price of a house. This is one of those gray areas that you have to deal with and one of the places where you need to look not only at the trust's resources but also at the beneficiary's decision making.



When deciding whether or not to use trust assets to buy a home, be certain that the beneficiary will actually be able to afford to live there. He or she will now be responsible for the house's ongoing expenses, maintenance (both major and minor repairs), and real estate taxes. If you've gone to the trouble of purchasing the house and distributing it outright to the beneficiary, you want to be certain that the beneficiary won't turn around and try to drain it of cash. One of us worked on a trust that used almost all of its assets to buy the beneficiary a house outright. A month after the closing, the beneficiary was already trying to raise a mortgage on the house; two years after the purchase, the city where the beneficiary lived foreclosed on his home for nonpayment of taxes.



If you think the beneficiary would be better off living in stable housing rather than going from rental to rental, but you're not sure that he or she is likely to be able to afford the upkeep and taxes on a house, you always have the option of having the trust purchase, and own, the property. This way, you know that the necessary bills are being paid, and you can arrange regular inspections to determine what, if any, maintenance must be done. Although doing so is more work for you, at least you'll rest assured that, whatever shortcomings the beneficiary may have in his or her life and financial dealings, at least he or she will have a stable and comfortable place to sleep each night.

Starting a business

In most cases, stifling the earning capacity of the trust's beneficiary isn't the grantor's goal; still, you the trustee face a tough decision when the beneficiary comes looking to you for money with which to start a business or to additionally capitalize a business that may require a cash infusion in order to stay afloat.

Your decision to distribute trust funds for this purpose depends largely on your confidence in the abilities of the beneficiary and his or her business plan. Your job isn't to be a nice guy; it's to request and study a business plan and to make your judgment based on sound business principles, not pie-in-the-sky projections.



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You may determine that you don't want to deplete the trust's assets in order to support the beneficiary's business, but that the business plan has merit. If you feel that the beneficiary would be able to obtain a loan from a bank or other lender on the strength of the business plan, you may loan the money to the beneficiary, making sure to have the beneficiary sign a promissory note that requires repayment of the principal and payment of interest at market rates. If you're not sure what interest rate to charge, the IRS issues *Applicable Federal Rates* every month, which tells you the minimum interest rate you can charge on a loan in order for it to be considered a fair market rate. You can find these rates at `www.irs.gov` under the Index of Applicable Federal Rate (AFR) Rulings.

Trustee's discretion

The grantor, in creating the trust, may have thought he or she'd covered every possibility, but life has a funny way of presenting situations you thought were impossible. Welcome to the world of the trustee's discretion, where truth is often stranger than fiction. If a beneficiary asks for a distribution and the trust instrument isn't clear about that request, you, Mr. or Ms. Trustee, need to decide. Remember that the grantor trusted you with making these types of decisions.

Keep your wits about you. Ask the beneficiary lots of questions and review third-party documentation, when available. Most of all, take your time and deliberate carefully. Put yourself in the grantor's shoes as you weigh your decision, taking what you know about the beneficiary into consideration. Even though many of the requests you receive from beneficiaries will be valid, others be a creative attempt to separate the trust's assets from the trust. On the small end, we've received requests to pay veterinarian bills and buy new cars. On the larger side, we've helped buy major-league sports teams and financed movies. Sometimes the distributions have been made and other times they haven't. Remember, you're not required to dispense money just because a beneficiary requests it.

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Chapter 14

Creating and Keeping Trust Records

In This Chapter

- Putting together a filing system
- Preparing annual accounts

You probably know at least one person who never balances his checkbook, who keeps track of his money by rounding to the nearest dollar or ten, who thinks that he must have money in the account because he still has checks in the checkbook, and who shows up at his accountant's office on April 14 with a shoe box of receipts. We'd love to be able to tell you that you can administer a trust this way — that the trust elves come in each night to do all the work of the trust — but we'd be lying. A competently managed trust is one where you keep, maintain, and update records on a regular basis. You have no room in trust management for approximation or procrastination; every penny counts and must be counted. In this chapter, we explain the nuts and bolts of what records you should keep, the information you need to create them, and how long to retain them.

Creating a Filing System

Staying organized is important in many of life's tasks and duties, and no more so than when you're a trustee. The grantor has relied on you to handle the trust's assets competently. When you're organized, you know where the trust's important documents and records are, which helps you to properly and efficiently administer the trust.

Organizational lapses can mean extra time spent searching for a crucial piece of correspondence or, more important, failure to make a required distribution or file and pay the trust's taxes. Start off your administration in as organized

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a fashion as you possibly can, and as with most things in life, you'll find that almost everything you do will be easier and take less time. This section helps you set up that initial organization.

Getting started: Organizing the right way

Beginning on the right foot when administering a trust is important. So where do you start? The day you discover you're a trustee is the day you should begin organizing the trust's administration. What do you do to begin? Head to your local office supply or stationery store for the following items to help you get organized:

- **Paper supplies:** Pick up manila files, file folders, labels, special accounting pads (if you're not comfortable working with a computer spreadsheet), legal pads (or whatever you prefer to make notes on), and anything else you think may be useful to you.
- **Various ink stamps (and ink if necessary):** If you're going to be collecting dividend and/or interest checks, you may want to purchase a "For Deposit Only" stamp for the back of your checks, or a date stamp to put on all trust correspondence you receive.
- **A filing cabinet:** You really want one that locks and is reasonably fire resistant.
- **A computer, printer, and Internet connection (if you don't already have them available to you):** If the trust is large enough, complex enough, and will continue long enough to warrant the cost, these investments will be invaluable.



Most of the work you need to do for any trust can be done on a computer, and having one can save you a great deal of time and money over the course of the trust's administration.



With your supplies in hand, create some file folders. Here are some you positively, definitely want to have, whether you have a manual or electronic filing system. Keep in mind that some of these files can be destroyed at a later date; others you may want to have bronzed. The following list shows you which files you want to keep permanently:

- Trust instrument
- Beginning inventory
- Annual accounts

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You can destroy these files after you're done with them. Remember, though, that the concept of temporary is relative. In many cases, you're not going to want to toss these files onto the bonfire for many years:

- **Bank statements and cancelled checks, filed by date:** You can destroy them after you've prepared the annual accounts and after beneficiaries have assented to those accounts. If this is a probate trust, hang onto them until the probate account has been allowed.
- **Brokerage statements and stock trade confirmations, filed by date:** Hang onto them as long as you keep the bank statements and cancelled checks.
- **Income tax returns, either filed sequentially by date in one folder or in separate folders for each year's returns:** Keep copies of all income tax returns for at least seven years after you file them.
- **Correspondence, filed by date:** Depending on the content of the letters, you may want to hold onto old correspondence until the trust terminates and all accounts have been assented to. You can place the really old correspondence into storage, though.
- **E-mails, plus memos and notes regarding phone conversations and meetings, filed by date:** Hold onto them as long as you keep your correspondence files. You'd be surprised how often you need to reference historical information.
- **Billing:** Yes, as trustee you bill the trust for your fees, unless you choose to forego a trustee fee because the trust is for a family member or for some other reason. You want to keep a record of what you bill and what you base your fee on. You can destroy them together with the bank and brokerage statements.
- **Miscellaneous:** This file is where you put anything you think is important but doesn't really fit into any of the other categories. If you're placing old correspondence, e-mails, and memos into storage, you probably should put these old miscellaneous files there as well. After the trust terminates (see Chapter 15), you can destroy them.

  Of course, every trust is different, and you may find that your miscellaneous file is the biggest one in the drawer. If that's the case, see whether you can group that information into some additional file categories and shrink that miscellaneous file down to a manageable size. The more finely you're able to slice and dice the information you're keeping, the more easily you can find exactly what you're looking for when you need it. If you're administering multiple trusts, or if you just want to make your file folders more portable, file them in an expandable manila file and then in the locking filing cabinet.

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Keeping the trust instrument handy

You may have already read the trust instrument and be fairly certain you know what's contained in it. But believe us when we tell you that reading a trust instrument isn't like reading a novel; you can't read, and comprehend, everything in it sequentially. We can guarantee that before you hit the bottom of page 2, your eyes will be glazed over, and you'll wonder what you did to deserve this. By the time you actually reach the signature pages at the end, you won't even remember the name of the trust, let alone recall what Article VII or Paragraph 3(B)(ii)(c) says.



Because a trust instrument can be quite confusing, you want to be able to refer to it whenever possible to clarify any questions you may have. That's why you want to keep a copy of it close by so you can easily access it. You may want to scan a copy into your computer, where you can open it up at will whenever necessary. Or you may prefer to maintain a hard copy in a three-ring binder or a manila folder. Whatever you do, and wherever you keep it, make sure that it's fastened in and that all the pages are fully legible. If you choose to use any sort of binder, make sure to reinforce the punched holes. We can guarantee that you'll read and reread this document so many times over the years that the paper will begin to shred over time. Make sure that the instrument is always fully legible; as pages begin to fade, you should recopy and replace them as necessary.

Compiling correspondence

A trust is an ongoing organism, and what happens today most certainly impacts tomorrow and next year. That's why keeping careful records of all correspondence that you receive and send is essential. You may want to compile these in a folder in a manila file, as we discuss earlier in the chapter, or in a three-ring binder. As your correspondence grows, you may want to separate it out by subject or type, such as correspondence from the grantor, or correspondence with the IRS.



Sometimes the most important aspect of a particular piece of correspondence is that you sent it. When you mail anything that you're required to mail, such as tax returns or certain correspondence to beneficiaries or courts, make sure to send it certified mail. When you need to know that something you've mailed has been received, send it certified mail, return receipt requested And because you're paying extra to prove that you've mailed something or that someone's actually received it, staple those receipts to the copies of the letters you sent so that you have the evidence handy should anyone need to see it.



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The key to organizing nonpostal communication is keeping a paper (and/or electronic) trail. Remember to keep copies of all e-mails that you send and receive, and keep notes on all phone conversations, listing the date and time of the call, to whom you spoke, the subject matter, and whatever course of action or resolutions were decided. By keeping a pad of paper next to the phone where you conduct trust business, you'll always be sure to have the tools necessary to keep accurate records. If you have meetings with the beneficiary, an investment advisor, or for any other trust-related purpose, take and keep dated notes of all pertinent information from the meeting.

Filing financial records

As trustee, you also want to keep accurate records of the trust's financial records you receive from banks, brokerages, or other sources. Keep all those brokerage and bank statements year by year in individual files. For a trust that maintains two bank accounts and a brokerage account, for example, you should have three files for each year, one for each of the bank accounts and one for the brokerage account. In each file, keep the monthly statements, as well as any cancelled checks, deposit slips, or purchase and sale confirmations. Files should be kept in date order so that when you need to find a particular transaction, you can put your hands on it easily.

Preserving annual accounts

If you compare organizing financial information to making a big pot of soup, the financial records you receive from all sources are the ingredients, and the soup they create is the annual account. *Annual accounts* are those compilations of all the trust's activity for any 12-month period that you distill from all the information you receive. Check out "Assembling the desired information" later in the chapter for info on how to prepare one.

Not every trust instrument requires that you have annual accounts, but preparing them on a regular and timely basis is a really good idea whether they're required or not. Your trust instrument should indicate clearly whether you're required to prepare these accounts annually or only if a beneficiary asks to see one. Either way, pulling together all of your financial data into one place allows you to see how the trust has done over the past year. You can see what investment mistakes you've made and how to avoid them in the future. And, should a beneficiary or court demand to see one, you won't have to scurry around, trying to create one under pressure.

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After you begin accumulating annual accounts, make sure that you have a file ready to hold the finished product. Like with financial statements, file them in date order so you can access them easily. It's not at all uncommon to have to go back through years of annual accounts in order to mine certain types of information, such as unequal distributions to beneficiaries. By having these accounts prepared, in order, and easily found, culling the information you need is a simple task.

Referencing tax returns

Maintaining copies of the trust's income tax returns for seven years seems fairly obvious; after all, that's what you do with your individual returns, right? As trustee, you need to keep copies so you can easily reference past tax returns as needed. Depending on the size of the tax return, and the amount of underlying information that's needed to prepare the returns, you can either choose to file all tax returns by date in one file, or open a new file for each tax year.



Very often, the initial assets inside a trust arrive via a decedent's estate. When this happens, make sure to obtain a copy of the **Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return**. In it, you'll find the estate tax values (which will be the trust's cost basis, as we discuss in Chapter 18) of all the assets that have now rolled into the trust. Hang onto a copy of Form 706 for as long as the trust is in existence; although you'll refer to it less and less as time goes on, you may need to find an estate tax value on some quirky little asset that landed in your trust many, many years after the grantor's death.

If the trust owns business or partnership interests, consider hanging onto the trust's income tax returns (including all supporting documentation) for the trust's lifetime because the year-to-year activity in the partnership or business may impact the trust's cost in that business or partnership. When the entity dissolves, or the trust sells its share, having that information handy may be crucial in determining what tax, if any, is owed.

Preparing an Initial Inventory and Valuing the Assets

The starting point for any trust is the property funding it. This property is listed on the trust's *initial inventory* (that is, a list you create of all the initial assets of the trust), where you show each asset's *cost basis* (the acquisition

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cost it carries as it enters the trust, which may be the grantor's purchase price, or the date-of-death value for assets that flow into the trust from a decedent's estate).

Although preparing the initial inventory may seem like a daunting task, it's really not. You already should have all the necessary information; it's just scattered. This section shows you how to collect and sort the data into a nice, neat package. Remember, the beginning inventory is the starting point of the trust's history, which you'll eventually trace from inception to termination by creating accounts, which we explain later in this chapter, in the section "Producing Annual Trust Accounts."

Arriving directly from the donor

When putting together the list of assets, you need to value the decedent's assets to ensure that your records are complete. Property placed in trust during the donor's lifetime carries with it the donor's adjusted basis and acquisition date. How can you calculate that basis? It's usually as simple as the amount the donor paid to obtain the property. Thus, 50 shares of XYZ Corp that the donor purchased on April 15, 2000, for a total of $5,000, and then donated into his revocable trust on April 15, 2008, has a basis inside the trust of $5,000 and an acquisition date of April 15, 2000. If the trustee then sells these shares on April 16, 2008, for $10,000, the holding period is eight years, not one day, and the capital gain is long term.

The donor's basis may be adjusted if, for example, he or she reinvests dividends or if improvements are made to property (or a portion of the property is damaged due to a casualty loss). Also, if the trust is revocable before the donor's death (refer to Chapter 3), the basis of assets the donor has placed inside the trust prior to death will change to the value on the donor's date of death, or to the value six months after death, if the estate chooses to use alternate valuation. Check out Chapter 16 for more on how basis changes at death.

If a donor funds an *irrevocable inter vivos trust* prior to death (see Chapter 3), the assets in the trust retain the donor's adjusted basis and acquisition date. There is no change in basis or acquisition date when the donor dies.

Coming from the donor's estate

Property that funds a trust via the donor's estate carries with it the donor's date-of-death value (or alternate valuation, if the executor has elected to use that method of valuation in order to reduce estate taxes). Whether valued as

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of date of death or alternate valuation date, it'll be considered as acquired on date of death. Any sales within the first year of acquisition are long term, for the purpose of calculating capital gains and losses.

Compiling Records of All Transactions

After you create an initial inventory, you can begin tracking the activity in the trust account. Just like maintaining a running balance in your own checkbook, tracking this basic information helps in any number of ways. With it, you can determine how much is available to distribute to the income beneficiaries (Chapter 13), while at the same time keeping track of the trust's ongoing tax situation (Chapter 18). By recording all the transactions, you'll gain some insight into how much you should charge for your trustee's fee. So, every time you buy or sell a security, receive interest or dividend payments, or make any payments (taxes, fees, beneficiary payments), you need to record that transaction. If there's activity in the trust accounts, you need to capture it. If you miss something along the way, watch out! When it comes time to create your annual account, missing transactions will mean that your account won't balance.

Knowing the difference between income and principal

As you keep track of these transactions, you need to understand the difference between income and principal. Unlike your personal accounts, where you probably lump all your funds together and then pay your bills from the pot of cash, trusts differentiate between *principal,* or the assets of the trust, and *income*, or the money earned by the assets. Distinguishing between income and principal can sometimes be confusing because certain types of income are actually considered principal (such as capital gains), and others remain segregated on the income side of the account. Chapter 12 discusses more fully how to make the distinction.

However just keeping track of the approximate records isn't enough when administering a trust. Precision is the key to success, both for administration and for tax compliance, and no more so than when keeping track of basis information. (*Basis* is your carrying cost in any piece of property of whatever type. It may be the price you paid for the property, the price the donor paid for it, the estate tax value if you've received the property from an estate, or any combination.) You have to know what the trust's cost is in an asset before you can make an informed decision as to what to do with it, and should you decide to sell it, you need to know the basis, down to the last dollar, in order to correctly calculate the capital gain or loss.

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Don't rely on brokerages or mutual fund companies to keep track of your cost basis in securities. Our experience is that they're satisfied with approximate costs, so they do things like merge tax lots or fail to allocate basis to new companies spun off from a parent corporation. Why does it matter? Each time you buy a security, you create one tax lot; each time you sell, you may choose which lot or lots you're selling. By designating which shares are sold, you can generate either a larger or smaller capital gain or loss, depending on what's most advantageous to the trust. Keeping track of each specific tax lot allows you to keep all your options open.



Even if your broker supplies you with an informational schedule with its version of gains and losses, you're not obligated to use it, provided you have the supporting documentation necessary to back up yours.

Filing income tax returns annually

A trust is a taxable entity, and any income it earns must be reported annually, either on the grantor's Form 1040, in the case of a revocable trust, or on **Form 1041, U.S. Income Tax Return for Estates and Trusts**. Almost all trusts are required to file, using a calendar year (ending December 31), and the tax return is due on April 15 of the following year. If you're unable to complete and file the return by the filing deadline, you may file **Form 7004, Application for Automatic 6-Month Extension of Time To File Certain Business Income Tax, Information, and Other Returns** instead. Remember, any taxes owed for the prior year must be paid by April 15; the extension of time to file isn't an extension of time to pay. Chapter 18 tells you what you need to know in order to prepare **Form 1041.**

Producing Annual Trust Accounts

Trust administration is fairly similar to organizing your own finances. You have bank and brokerage accounts to manage, taxes to file, bills to pay. However, you do have to tangle with one major difference: Although your own finances probably toddle along quite nicely without you ever compiling the activity into one place, you need to create a trust account for every year of the trust's existence. This account traces all the activity in the trust from the ending balances of last year's account (or from the initial inventory, if this is the trust's first year of operation) to the closing balances at this year's end.

How do you know what to include and how to create a trust account? Don't feel too overwhelmed. This section shows you what you need to do.

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Assembling the desired information

Trusts, unlike estates, account for their activity with a strict separation between principal and income. Although you can format them in a variety of ways, Figure 14-1 shows a sample account in a form commonly used by most trust accountants. Remember that the mathematical concepts here are very simple: Schedule A minus Schedule B must equal Schedule C, and Schedule D minus Schedule E must equal Schedule F.



If all your assets are in one basket, so to speak, held either by a bank, a brokerage, or a law firm *fiduciary* (trust and estate) department, they should send you annual trust accounts. If you've scattered the trust's assets among a variety of financial institutions, the responsibility of compiling all the information into one easy-to-read account becomes yours.



Although annual account preparation may seem like a lot of work for little benefit, we strongly urge you to go through the steps to do it each and every year. Not only do you pick up any inconsistencies in your recordkeeping this way, but you also create a permanent record of set points in the trust's timeline. Down the road, should anyone question your handling of the trust, you'll have these accounts to support your arguments that the trust actually blossomed under your management.

Obtaining assents of beneficiaries

You've gone to the trouble of generating an annual account. Now you should sign it and then provide copies to all the beneficiaries for their *assent*, or agreement to what's contained in the account. The best, and easiest, way to do this is by preparing a summary cover sheet (which then becomes part of the account) for the account you've prepared, signing it as trustee, attaching it to the six schedules you've previously prepared, and providing a copy of the complete packet to the beneficiary, together with a photocopy of that cover sheet, which the beneficiaries then sign and return to you. These photocopies, after they have the beneficiary's original signature on them, become the beneficiary's assent to the account.

After obtaining assents from all the beneficiaries (and we do mean *all* the beneficiaries, including those people who aren't currently receiving any distributions but may in the future), attach these signed documents to the front of your account, and keep the whole kit and caboodle together in permanent file (which you're hopefully keeping in a fireproof safe). Figure 14-2 shows a sample cover page, with the assent line included, for the annual account shown in Figure 14-1.

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PRINCIPAL

Item #	Date	Description	Principal cash	Schedule A: Gains and additions	Schedule B: Charges, losses, distributions
1		Balance as per last prior account	0.00	100,000.00	
2	03/15/08	ZYX Corporation Sold 50 shares @ $25	1,250.00	250.00	
3	05/14/08	QRS Corp Sold 40 shares @ $50	2,000.00		400.00
4	06/18/08	MNO Inc Purchased 100 shares @ $32.50	(3,250.00)		
5	10/15/08	Trustee's fee paid – principal portion	(1,000.00)		1,000.00
6	12/31/08	Cash balance as per Schedule C	0.00		
				100,250.00	1,400.00

Schedule C: Principal Balance

Item #	Par value or # of shares	Description	Book Value	Market value (unit price) at 12/31/08	Total Market Value at 12/31/08
1	450.000	ZYX Corporation	9,000.00	45.00	20,250.00
2	100.000	MNO Inc	3,250.00	30.00	3,000.00
3	86,600.000	ABC Money Market Fund	86,600.00	1.00	86,600.00
4		Principal Cash	0.00		0.00
		Balance Schedule C	98,850.00		109,850.00

INCOME

Item #	Date	Description	Schedule D: Receipts	Schedule E: Payments
1		Balance as per last prior account	0.00	
2	01/31/08	ABC Money Market: interest	252.00	
3	02/28/08	ABC Money Market: interest	254.00	
4	03/31/08	ZYX Corporation: dividend	500.00	
5	04/30/08	QRS Corporation: dividend	250.00	
6	10/15/08	Trustee's fee: income portion		400.00
7	12/31/08	John Smith: income distribution		856.00
			1,256.00	1,256.00

Schedule F: Income Balance

Description	Book Value	Market value (unit price) at 12/31/08	Total Market Value at 12/31/08
Income Cash	0.00		0.00

Figure 14-1: Sample annual account for the XYZ Trust.

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Filing with the probate court

If your trust is governed by an instrument contained within the Last Will of the creator of the trust, you may file annual accounts with the probate court. In most cases, the annual account format shown in Figure 14-1 should be adequate, although you want to obtain the court's specific guidelines prior to finalizing your account. Instead of using the cover sheet shown in Figure 14-2, you have to use the court's cover, which you can obtain from the court by just showing up (one of the court officers will help you) or by requesting that they mail you a cover.

The Fifth Account of Jane Smith, Trustee of the XYZ Trust

This Account is for the period beginning with the first day of January, 2008 and ending with the 31st day of December, 2008

Principal

Schedule A Opening balance plus additions and gains $100,250.00

Schedule B Payments, charges, and losses $1,400.00

Schedule C Balance at end of period $98,850.00

Market Value $109,850.00

Income

Schedule D Opening balance plus receipts $1,256.00

Schedule E Payments and charges $1,256.00

Schedule F Balance at end of period $0.00

_____

Jane Smith, Trustee

Within account is hereby approved by: _____

Dated: _____

John Smith, beneficiary

Figure 14-2: Sample cover page for XYZ Trust annual account.



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Despite the fact that the probate court is, in fact, a court, and despite the fact that annual accounts may be required for testamentary trusts, all the courts we've been involved with haven't been exactly on top of us to get these accounts done and filed. Not getting pressure to file doesn't waive the requirement to file, and much like teachers and late homework, when the court goes looking for an account that's not there, they tend to get testy. If you must file accounts, prepare and file them in a timely fashion; finding all the financial records you need years after the fact is often difficult, and your memory of events may be spotty at best.

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Chapter 15

Terminating the Trust

In This Chapter

- Making final income and principal distributions
- Planning for, and preparing, the final tax return
- Checking your crystal ball for future expenses
- Wrapping up the final account

All good things must come to an end, and that includes trusts. A day will come when you've fulfilled all the terms of the trust and the need for it just goes away. This may happen when the income beneficiary dies or reaches a certain age, or all the principal has been spent. Whatever the reason, when the time comes for you to terminate the trust, you don't just get to wash your hands and say, "I'm done." Although the end scenario isn't difficult, you do need to follow a few rules and perform a few rituals before you can walk away from your duties as trustee.

In this chapter, we tell you what needs doing and when you need to do it. We explain how to make those final distributions, prepare that last tax return, set aside something for those contingent expenses that always seem to crop up, and finally wrap a nice bow around the whole package with your final account, which should show zero balances in both income and principal on the last day.

Distributing All Assets According to the Trust Instrument

No matter what event triggers the termination of a trust, you need to find new homes for the remaining assets before you can wrap up its affairs. Of course, none of this division is left to your discretion; the trust instrument has the disposition of the remaining assets spelled out in neon. All you need to do is go back to the instrument and find those provisions.

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The trust instrument spells out clearly who gets the principal when the income interest in that trust terminates. It may be the income beneficiary, who's reached a certain age and becomes entitled to the principal. Or it may be some other person — perhaps the income beneficiary's child, or some other descendant of the donor. The trust may even terminate in favor of one or more charities. These individuals are referred to as *remaindermen*. In fact, you may have any combination of events, with portions going in several directions. Your job, as trustee, is to determine how the remaining pie of assets gets split. This section spells out who receives the distributions.



Just because a trust is terminating as of a particular date doesn't mean that you need to make all the final distributions on that date. Trusts can be complicated, and doing the final wrap-up may take some time. Be patient, and move carefully. As long as you complete the business of the trust within a reasonable length of time (and no one, as far as we know, has ever truly defined *reasonable*), you're on safe ground here.

Determining any final income distributions required for beneficiaries

Before you can distribute the principal to the remaindermen, you must be certain that all the income you're required to distribute has, in fact, been collected and distributed to the income beneficiary. Making this determination is easy if the income beneficiary and the remainderman are one and the same person because that individual will receive everything, no matter how it's categorized. But if the principal is going to someone or someplace other than where you've been making income distributions, you have to pay any owed income before you can make distributions of principal.



How do you make the determination of how much you owe, if anything, to the income beneficiary? You do it all by dates. The income interest may end on the date the income beneficiary dies or turns a specific age, or after the trust has been in existence for a certain number of years. Read the instrument and be sure that you've identified the correct date. After you know the date the trust officially terminates, you can then calculate the final payout. For example, if the income interest terminates on February 2, you need to pay out to the income beneficiary not only all the income still in the trust on that date but also all the income that the trust was entitled to receive by that date but that hadn't yet been paid to the trust. So, if the trust owned QPWR Corporation stock, which said it would pay a dividend to its shareholders of record on February 1, but which wasn't actually paying the dividend until February 10, you'd need to include that dividend in your final income calculations, even though it wasn't received by February 2. Any income that's

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accumulated in the trust prior to the termination date belongs to the income beneficiary. In addition, though, you're going to make adjustments for the following items when terminating a trust:

- Accrued interest earned on any bonds held by the trust, or earned to the termination date in any bank accounts. Interest is earned on a daily basis, even though it's paid only periodically.
- Stock dividends that are owed to the trust but haven't yet been paid.
- Rents owed but not yet paid for the period from the end of the last rental period to the termination date.
- Partnership and business income from the date earned but not yet paid, through the termination date.
- State tax refunds attributable to income earned prior to the termination that are due but haven't been received.
- Any other miscellaneous income earned but not yet received prior to the termination.



Although doing the research and making all these calculations yourself is possible if you're only dealing with a few securities, save yourself the hassle and call your broker or a valuation service if the trust owns tens or even hundreds of securities. The amount you pay for the service is probably a pittance in comparison to the amount of time you spend doing the work yourself.

Holding back funds for final taxes and fees

Prior to fully terminating a trust, you need to ensure that you've put money aside to pay Uncle Sam and any other fees. Income needs to be reduced by any expenses accrued as of the termination date, such as trustee's and investment advisor's fees; state, local, and foreign taxes on income received and accrued; miscellaneous expenses; probate court costs (for filing annual accounts); and any other such fees attributable to the income earned in the trust as of that date. (Check out the later section, "Submitting the Final Income Tax Returns," for more on submitting the final tax return.)



If you've collected all the income but haven't yet paid all the expenses, you really don't need to continue to keep all that income in the trust. Instead, determine how much you think you'll need to pay the expenses and then pay out what remains to the income beneficiary. Be sure to estimate the expenses on the generous side; nothing is worse than having to ask the income beneficiaries to repay money they've already spent. You can either hold the money

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you set aside for future expenses in a separate, non-interest-bearing, non-trust account (a popular choice of law firms) or you may keep one of the trust accounts open. Remember, though, that after you make this move, you don't want to earn any additional income, especially after you've filed the final tax return. After you finish paying the expenses, the rest of that money should be promptly sent to the income beneficiary to close out the income side of the account.

Paying the remaindermen

When terminating a trust, you need to pay the *remaindermen* (the individual(s) or organization(s) named by the trust instrument to receive the remaining property after the trust's income interest has ended) if there are still any assets left (securities, cash, real estate, or that all-important country club membership) after you've made final income distributions to the beneficiaries and paid all the necessary taxes and fees. To identify these individuals or entities, carefully study the trust instrument to determine who gets what and how much.

As trustee, you have to be certain that your allocation of trust assets among the remaindermen is equitable, but you're not required to give each remainderman a proportionate piece of every asset. Typically, if trust principal is being divvied up into two or more pieces, the starting point for the division is the value of the assets on the trust's termination date, or the date that the income beneficiary no longer is entitled to any more income. Thus, certain assets that are difficult to divide, such as real estate, or businesses, or even some stocks and bonds, don't have to be sold in order to make sure that everyone is getting his or her exact proportionate share of every type of property. All that's required is that the allocation of the total value of all the assets is exactly proportionate to the shares called for in the trust instrument (which may be unequal shares). So if Alvin is scheduled to receive 60 percent of the remainder, and his brother Calvin the remaining 40 percent, of a trust that's worth $100,000 after the income interest ends, Alvin's share is worth $60,000 and Calvin's $40,000. It doesn't matter what property you, as trustee, put into each of their shares to arrive at those final values. All that matters is that each receives property equal to his proportionate share.



Knowing how to make the calculations necessary to divide up the property is one thing; actually transferring those assets to the remaindermen is another. Although cash can be disposed of by writing a check, transferring many of the other assets held by the trust is slightly more complicated. Property may be transferred to the remaindermen in the following ways:

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- **Stocks and bonds (publicly traded):** Notify the broker holding the securities of the transfer by signing stock assignments to transfer ownership to the remaindermen. If you're holding stock certificates in the name of the trust (and we sincerely hope you're not), you have to deliver the certificates, either in person or by using registered mail together with stock assignments, to each of the companies, who then reregister the stock in the name of the remainderman.
- **Stocks and bonds (privately held):** Contact the companies directly. They're most likely already aware of the transfer, and they'll provide you with the necessary documents to effect the change.
- **Real estate:** Draft a new deed, transferring title from you (as trustee) to the remainderman receiving the property and then record the new deed with the county, city, or town where the property is located. You may want to consult an attorney to draft and record the new deed, to be certain that all the formalities of the real estate transfer are observed.
- **Partnership interests:** Contact the general partner of the partnership with the name and federal tax identification number or Social Security Number of the new partner. Be aware that many partnerships are run by professionals (in which case the transfer will likely happen almost seamlessly), but others are operated by scratching notes on the backs of envelopes. If you don't receive confirmation that the transfer has happened, and you receive a **Schedule K-1** from the partnership still in the name of the trust for a year following the transfer, make a nuisance of yourself. Sometimes the surest way to get results is to be the squeaky wheel.
- **Royalty interests:** If the trust has interests in natural resource leases, notify the manager of the change in ownership. Like with partnership interests, give them a reasonable amount of time to change their records and then feel free to become insistent. If the royalties in question derive from intellectual property, such as music or books, provide the publisher with the information he or she requires to change the ownership interest.
- **Promissory notes or mortgages held by the trust:** Often, the trust will have lent money to a beneficiary or remainderman and evidenced that loan with either a promissory note or a mortgage. If the promissory note in question has the trust as the lender and the remainder interest as the borrower, no transfer is required. Just subtract the outstanding loan amount from the total amount payable to that remainderman, and you're in the clear. If, on the other hand, the loan was made to a third party, draft a new note and change the name of the lender, referencing the old note, and restating the terms. As with the real estate transfer, you may want to have an attorney assist you in making this change. And, if you're dealing with a mortgage that's been recorded, be sure that the attorney records the new mortgage and completes and files a mortgage discharge for the old.

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We've said it before, but it's worth saying again: Don't guess at the worth of hard-to-value assets, such as real estate or business interests — obtain a professional appraisal as of the termination date. Of course, if you can simply give the hard-to-value asset proportionately to the remaindermen and they all agree, a formal appraisal isn't necessary. For example, assume a trust owns an apartment building and has three remaindermen (children of the grantor). The remaindermen can agree to take a one-third interest in the apartment building and no appraisal is necessary. The remaindermen have been waiting a long time for their fair share of the trust's principal; any inkling that one or more of them has been shortchanged, and things may get ugly for you in a hurry.

Submitting the Final Income Tax Returns

You can't walk away from your duties as trustee until and unless you've filed a final **Form 1041, U.S. Income Tax Return for Estates and Trusts**. Fortunately, you're passing out all the tax liability to some or all of the income beneficiaries and remaindermen because you're passing out all the income and assets to them. The final tax return for the trust is, typically, nothing more than an information return.



When preparing the final return, keep the following important points in mind:

- **Make sure that you tick the *Final Return* box on the face of the return.** And, in case you think the IRS may miss that little box, feel free to also write "Final Return" across the top of the first page in big red or black letters. We can't begin to tell you the number of times we've received notices from the IRS looking for returns years after we filed the final one. Of course, just because it's looking doesn't mean you have to prepare and file one, but who wants to keep writing letters explaining why you're no longer required to?
- **Make sure that the return shows that the trust has reached zero taxable income and zero tax liability.** No matter how you slice it, every final year return should reach the same conclusion: zero taxable income and zero tax liability. The zero taxable income is achieved in two ways — by passing out all items of income and deduction (including capital loss carryovers and net operating losses) to the beneficiaries and remaindermen on **Schedule K-1**, and by disallowing the exemption amount that would ordinarily be allowed on a non-final return. Zero tax liability then naturally results. So, if the return you're preparing doesn't meet those two criteria, you need to sit down and take another look.

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Chapter 18 explains how to complete **Form 1041** in glorious detail. Remember to include all your deductions, even if you don't have enough income to offset them; excess deductions on termination of a trust are apportioned and distributed to all the recipients of **Schedule K-1**, and they can deduct them on **Form 1040, Schedule A** as a miscellaneous itemized deduction subject to the 2 percent adjusted gross income limitation. We explain how to prepare **Schedule K-1 (Form 1041)** in Chapter 19.

This section points out the final steps you may be required to take to ensure that the trust has met all its tax obligations. Not to worry, though — because you've been handling the trust's taxes for a while already, all the information you need should be easy to access.

Determining any final tax liability

Just because the final **Form 1041** shouldn't have any income tax liability doesn't mean that you may not still have some outstanding tax obligations, either from a prior year's return or from a state or local government. You need to double-check and determine whether the trust has any final tax liability, perhaps due to tax returns for prior years that haven't yet been filed, an income tax audit that hasn't been resolved, amended returns for prior year(s) that are still awaiting your attention, or even unpaid real estate taxes.

In order to make the determination, be sure that you have completed returns for each year of administration and that you have no knowledge of any open issues regarding any of them. Remember, if you're receiving correspondence from the IRS or any state tax department, that's a sure sign that you need to resolve a problem somewhere. Rough out any tax returns still to be completed or filed at the time the trust terminates its income interest so that you don't receive any unpleasant surprises. Be sure to segregate any taxes you think you owe before making any payments to income beneficiaries or remaindermen. Remember, many trusts terminate in the first few months of a year, before you've finished the prior year's tax returns. Even if the trust won't owe any taxes on the final year return, the same can't be said for the prior year's return, the very return that may well be sitting, unfinished, on your desk.

Make payments of the taxes the trust owes before you begin making distributions to the remaindermen, even if you're not absolutely certain of the final tax bill. If you only have a rough idea, generously estimate the payment, and send it in. If you know exactly how much the trust is on the line for, write that check and get it out of the way. Dealing with a tax refund is far easier than getting the remaindermen to cough up money to settle the trust's tax liability.

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Filing a short-year return

Trusts rarely terminate on December 31. Accordingly, the last year of the trust's existence will most likely be a *short year* (less than 12 months), and you may want to file a short-year return. Using a short-year return allows you to conclude the trust's business in a timely fashion instead of allowing preparation of that final return to hang over your head for months after you've completed all your other trust-related tasks. Short-year returns are prepared just like any other return, with two exceptions:

- You're allowed to use the prior year's tax form if the current year's form isn't yet available. If current year forms aren't yet available, you may want to superimpose the correct year over the printed prior year.
- You must fill in the dates of the short year at the top of the return.



If you opt to use a short year for the final return, don't forget that the return is still due three and one-half months after the end of the year you've chosen. So, if you elect to end the year on November 30, your short-year return is now due on March 15, not April 15.

Preparing Final Accounting and Obtaining Assent of All Remaindermen

You've distributed the final income amounts, paid all the last expenses, and filed the final tax returns. You're almost done — but not quite. You're not allowed to move your trusteeship into the completed column until you do one last thing: prepare a final account and obtain assents from all the remaindermen.

Finally finishing a non-probate trust

You prepare this final account just like all the others you've prepared up until now. You'll know this is the final account because you'll mark it *Final* on the cover page, and Schedules C and F will show zero balances. As you prepare this account and then obtain the signatures of the beneficiaries, keep the following in mind:



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1. **Don't discontinue preparing your annual accounts just because the income interest in the trust has ended.**

   It may take years after the income interest has terminated before you actually get to prepare the final account. Sometimes, even though the trust is terminating, the assets remaining don't transfer to the remaindermen for a very long time. So long as you're responsible for any assets, you need to account for them. The good news (you knew it was coming) is that trusts that are in the process of terminating aren't usually very active, so the annual accounts are much less involved than they were when you still had income beneficiaries to worry about.

2. **After you prepare the final account and sign the cover page, give it to all the remaindermen to sign off on.**

   You don't need to have the income beneficiaries sign off on your accounts after the income interest has expired.



   You may want to have an attorney draft the final assent letter, one that the remaindermen sign, that releases your liability with acceptance of the distribution. Nothing is worse than when a trustee releases all the assets and fails to obtain assents, only to be sued later when the trust no longer has any assets.

   After you've obtained the necessary assents in the manner described in Chapter 14, you're finally finished. Congratulations!



Be sure to provide copies of accounts to beneficiaries and remaindermen when you ask for their assent. And keep the originals of all the accounts, including this final one, and all the signed assents permanently. In a case of better-safe-than-sorry, you can never be certain when someone will raise a question regarding your period of trusteeship; with the accounts and signed assents in hand, you have proof not only that the beneficiaries or remaindermen have prior knowledge of your acts as trustee but also that they assented to them at the time.

Polishing off a probate trust

Prepare the final probate account in the same manner as you would a non-probate account, and attach the official probate court cover to it. Here are a few things to keep in mind:

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- Be sure to mark the account not only by its number but also as *Final* (The Fifteenth and Final Account of Jane Smith, Trustee). Sign the cover page as trustee.
- Like the non-probate trust account, you need to obtain assents from all the remaindermen before you can officially close the trust. Usually, the probate court provides you with its official assent form to use for this purpose.
- Be sure, when mailing assents out to the remaindermen, that you send them either registered or certified mail, and that you request return receipts. Doing so ensures that if one or more remaindermen is balky in providing the requested signature, you have proof for the probate court that you sent the form and that the obstinate remainderman did receive it.

After you receive all the assents, you may choose to have your accounts allowed by the probate court. If you opt for allowance, the probate judge will review your administration from the filing of the probate inventory through all the annual accounts and ending with the final account. He or she will review the size of the fees that you took for your administration, as well as make sure that income was distributed as required and that the trust principal was distributed in accordance with the instrument. Allowance isn't absolutely required, but if you choose to go that route, it never hurts to know that the probate court, under whose auspices you administered this particular trust, approved your administration.



If, when you petition the probate court to have your accounts allowed, any of the income beneficiaries or remaindermen are minors or are otherwise incompetent to legally act for themselves, the court may require that you have a *guardian ad litem* (literally, a guardian for this matter only) appointed to protect his or her interest. In theory, having someone who's otherwise unconnected to the trust and the family protecting the minor's interest isn't a bad thing; in practice, the court typically appoints a lawyer as guardian — someone who asks lawyerly questions and charges lawyerly fees. Although you can't always avoid the appointment of a *guardian ad litem*, try to steer clear of this step whenever you can by filing your accounts when they're due but waiting until all the income beneficiaries and remainderman are of legal age and capacity before you ask the court for allowance.

Part IV

Paying the Taxes

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"You know that mail order company that promised to show you how to avoid a tax audit? Well, their package just arrived."

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In this part . . .

One of the inevitabilities of life — taxes — is nowhere more apparent than when dealing with estates and trusts. No matter what you do or how you do it, you need to examine the tax consequences of your decisions. You may have estate taxes that need to be paid after a decedent dies, or income taxes owed by an estate, a trust, or even by the decedent him- or herself. In fact, so many types of taxes may be triggered by death or by funding a trust that you may not even be aware some of them existed before you assumed your role as fiduciary.

In this part, we clue you in — in plain English — on just how to complete some of the most common types of tax returns, including the estate tax return, and the income tax return for estates and trusts. We also show you how to report tax information to estate and trust beneficiaries, both when you're required to file an income tax return for the estate or trust and when you're not.

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Chapter 16

Preparing the Estate Tax Return, Part 1

In This Chapter

- Determining whether your estate needs to file
- Filling out pages 1–3 of the estate tax return
- Deciding which elections to take
- Taking the final steps after you've filed the return

"Nothing's certain in life apart from death and taxes." Ben Franklin said it, and it's generally true. Although death is unfortunately inevitable, the federal estate tax isn't if the decedent's *estate* (the property owned by the deceased person on his or her date of death) is small enough. For decedents passing away in 2008, the amount exempt from federal estate tax is $2 million and in 2009, that amount increases to $3.5 million. We discuss later in this chapter what is scheduled to happen after that, but who knows? Congress may rewrite the rules and change the exempt amounts.

The federal estate tax, sometimes mistakenly referred to as the *death tax*, is a tax on the value of all the decedent's property at date of death, minus any amounts owed by the decedent but unpaid at that time, funeral costs, and costs of administering the estate. It's not a tax on a share received by any particular beneficiary, and no beneficiary pays any gift or estate tax on what he or she receives. The executor or administrator pays any estate tax owed from estate assets nine months after the decedent's date of death.

In this chapter, you find out how to decide whether you must file a **Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return** for the estate, and whether any tax is due. With the information located here, you can prepare the opening pages of the 706, make the appropriate elections for the estate, compute the tax, and file the return.

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Figuring Out Which Estates Must File

The good news is that making the decision about which estates must file is easy. Uncle Sam already made the decision; most estates need not file an estate tax return at all. Read on to see whether you can dodge this particular bullet or need to start filling out the forms.

Who must file

The IRS estimates that only a small number of estates are required to file. So how do you figure out whether the estate you're administering falls into that category? The answer depends on the size of the *gross estate,* or the total value of everything the decedent owned as of date of death, and the year in which he or she died. If, for example, you're administering an estate for a decedent who died in 2008, you don't need to worry unless the gross estate is worth more than $2 million. In 2009, that number rises to $3.5 million.



Of course, figuring out whether you must file is never quite that simple. In order to help you make an accurate determination whether you have to file a Form 706 for the estate, you need to also consider

- **What the decedent gave away over his or her lifetime as gifts:** The decedent's most recent gift tax return (Form 709), if any, lists all gifts he or she made during lifetime that need to be added back. If you can't locate the decedent's most recent 709, you can request a copy from the IRS by using Form 4506. (Check out Chapter 7 for how to do so).
- **Whether the decedent's estate looks like it could be anywhere close to the exempt amount for the year in question:** If so, you need to do all the valuation calculations we explain in this chapter and Chapter 17 to be sure that you don't need to file, including getting appraisals where necessary. Filling out drafts of the schedules is a helpful way to accomplish this.



At the time we're writing this book, the estate tax is scheduled to disappear for one year in 2010, only to reappear in 2011 with much higher tax rates and much lower limits on gross estates. Of course, nothing is ever written in stone until you actually get there (and sometimes not even then). So, check carefully before you begin preparing a Form 706 to make sure that one is actually required. The easiest place to check is the IRS itself at `www.irs.gov` — nothing like the horse's mouth. Look for **Publication 950, Introduction to Estate and Gift Taxes,** for the amounts applicable to the year in which your decedent died.

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Who actually files the 706 for the estate? As the executor, administrator, or personal representative of the decedent's estate, you're responsible for filing the 706 if the gross estate is larger than the applicable exclusion amount for the year in question. If the estate has no appointed executor, administrator, or personal representative, and you're a trustee in *actual* or *constructive possession* (you have control over the property even if it's not held in the trustee's name) of any of the decedent's property, you're responsible for any required Form 706.

The estate tax is due in full nine months after the decedent's date of death unless you request and are granted an election under section 6166 of the IRS Code to pay in installments, or under section 6163 to pay the part of the tax attributable to a reversionary or remainder interest at a later time. (See "Electing to pay the tax in installments" and "Electing to postpone taxes" later in this chapter for more info on sections 6166 and 6163, respectively.)



If the tax you're paying with the return differs from the amount that the return shows is due, attach a statement to the return explaining the difference. If you've already made payments to the IRS, attach a statement to the return to that effect.

When to file

If the estate must file an estate tax form, file the 706 and pay the estate tax and any generation-skipping transfer (GST) tax nine months after the decedent's date of death. However, you may file an extension of time to file Form 4768 (discussed in "Extensions of time to file and pay tax" later in this chapter) by the due date for filing the return. We discuss the GST tax in Schedule R in Chapter 17.

Reaching the applicable exclusion amount

Don't worry, the *applicable exclusion amount* (the amount of the decedent's assets you can actually exclude from estate tax) is a rather difficult concept. Lucky for you, you never have to make this computation. It's all done for you on page one (the cover page) of the Form 706 by means of a credit subtracted from the gross estate tax calculated. So for example, in 2008, the applicable credit subtracts $780,800 from the gross estate tax, which shelters the first $2 million of the taxable estate. In 2009, the applicable credit increases to $1,455,800, which shelters the first $3.5 million of the taxable estate. Unless Congress acts, the estate tax goes on vacation in 2010, and in 2011, the applicable credit applied to the estate tax drops back down to $292,000, which shelters the first $1 million of the taxable estate.

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Obtaining a Release from Personal Liability

Whether you filed the decedent's 706 as executor or trustee, you always want to obtain a release from personal liability under code section 2204 (do the same for the decedent's income and gift tax returns). That's because, even if the estate or trust is later found to be liable for additional tax, perhaps due to assets discovered years later, for instance, if you've obtained the release from personal liability, you aren't personally liable for the tax. Send a letter to the IRS in your capacity as executor or trustee and as the person charged with filing the Form 706, requesting that the IRS set the estate tax and discharge you from personal liability.

After the IRS receives your request, it has nine months to act on it. As soon as you pay the tax the IRS assesses, you're released from personal liability for any tax deficiency later discovered. You're then free to pay other debts and expenses of the decedent — which come after the federal estate tax in priority of payment — and distribute the assets. Even if an asset appears later, you're off the hook; if additional tax is later assessed after you've distributed the assets, the estate or the beneficiaries will be liable, not you.

Understanding Some of the Nitty-Gritty Rules for Filing the Form 706

You need to know some basic rules for how and where to file the **Form 706**, how to pay the tax, how to get an extension of time to file or pay tax, and what documents to file with the return. That's what we give you here.

Where and how to file

You pay the appropriate estate tax nine months after the decedent's date of death. Send the completed tax form to Department of the Treasury, Internal Revenue Service Center, Cincinnati, Ohio 45999. Use either certified mail or a private delivery service that can provide you with documentation. The IRS accepts the following delivery services:

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- **DHL Express (DHL):** DHL Same Day Service, DHL Next Day 10:30 am, DHL Next Day 12PM, DHL Next Day 3:00 PM, and DHL Second Day Service.
- **Federal Express (FedEx):** Fed Ex Priority Overnight, FedEx Standard Overnight, FedEx 2 Day, FedEx International First
- **United Parcel Service (UPS):** UPS Next Day Air, UPS Next Day Air Saver, UPS 2nd Day Air AM, UPS Worldwide Express Plus, and UPS Worldwide Express



Be sure to get written proof of the mailing date from the delivery service, because that day is considered the date of filing and of payment of the tax.

How to pay the tax

In order to pay the estate tax, you basically have two options:

- **By check, bank draft, or money order:** Make it payable to "United States Treasury." Be sure to include on the check the decedent's name, Social Security Number, and the words "Form 706," which indicates to the IRS what tax you are paying and for whom.
- **By credit card or debit card:** Go to `www.irs.gov` and enter "pay taxes by credit card" in the search box. Clicking on the first search result gives you a list of all the service providers you may use, their fees, and their Web sites and telephone numbers.

  Be aware that their convenience fees can be substantial for credit cards (between 2.49 and 3.93 percent of the tax payment at the time of this writing). You may find it much more prudent to make sure that you have the funds available to write that check than to explain to the heirs or a judge reviewing your estate accounting why you incurred the convenience fee.



Penalties for late filing, late payment, and understatement of valuation

Do all you can to file your 706 by the due date (as extended) and pay the tax on time, because you incur penalties for late filing and late payment unless you can show reasonable cause for the delay. If you're filing the 706 after the due date and any extensions, be sure to attach an explanation to the return

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to try to show reasonable cause. In addition, you pay interest on the amount of tax due from the due date for filing until the tax is paid, unless you've applied for and received an extension of time to pay the tax as discussed below.



Absolutely nothing is worse than getting slammed with penalties because the IRS catches you undervaluing assets. Not only do you have to pay the additional tax, but valuation understatements that result in tax increases of more than $5,000 also cost you a whopping 20 percent penalty. The IRS defines a *valuation* understatement as reporting the property's value as 65 percent or less of its actual value on the Form 706. The penalty jumps to 40 percent for property valued at 40 percent or less of actual market value. And if you think you like your chances of avoiding an audit, think again. In 2006, although audit rates on individual income tax returns hovered around 1 percent, the IRS examined almost 10 percent of all Forms 706. For estates reporting values of 5 million dollars or more, that rate rose to more than 23 percent. Valuations aren't places to cut corners or hope to get lucky, although you certainly want to use the lowest valuation supportable, in most cases.



When might a higher valuation be beneficial to the estate? When the estate doesn't owe any estate tax anyway; the value at which the property is included on the 706 is its new "stepped-up" cost basis for income tax purposes. See Chapter 18 for a discussion of the step-up in basis of a decedent's property to the date-of-death value for purposes of computing capital gains.

Signature and verification

List all executors or administrators on the return if you're dealing with more than one, because you're all responsible for the return's contents. You're also all liable for any penalties for erroneous or false returns. However, only one of you, as coexecutor, is required to sign the return regardless of how many of you are on the team. We strongly recommend that all coexecutors sign the return if at all possible so that it's clear to each of you that you're all liable for the return as it's filed. Relying on one coexecutor who is knowledgeable in 706 preparation to prepare the return is fine, as long as everyone else thoroughly reviews the return, asking any and all questions they may have. Feel free to ask to see the backup information!



The executor who prepares the return must sign the declaration on page 1 under penalty of perjury. If you rely on a paid preparer, such as an attorney, accountant, or enrolled agent, to prepare the return, they must also sign and complete the preparer info on page 1 of the return.

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Extensions of time to file and pay tax

Sometimes you may need a few extra months to get everything squared away with the estate before you can file the 706. If you need an extension, send your extension request to the Department of the Treasury, Internal Revenue Service Center, Cincinnati, OH 45999, no later than the original due date for the return (nine months after date of death). File **Form 4768, Extension of Time to File a Return and/or Pay U. S. Estate (and Generation- Skipping Transfer) Taxes** to apply for extensions of both time to file and time to pay.

Extension of time to file

You receive a six-month automatic extension of time to file with regard to Forms 706, 706-A, 706-D, 706-NA, and 706-QDT as long as you file the extension request by the due date and include payment of the estimated amount of the estate tax (or generation-skipping transfer tax). Just check the applicable box in Part II of the form.



If you have multiple executors or administrators, only one of you needs to file, or you can have your authorized attorney, certified public accountant, enrolled agent, or agent holding power of attorney file for you.

You may apply for a discretionary additional extension of time to file the 706 only if you are an executor and are out of the country. Attach a statement explaining why it's impossible or impractical to file the 706 by the due date.

Amending Form 706

You often discover additional assets or expenses that you should have included on the Form 706 long after you file it. If you come across assets or deductions after filing the Form 706 and within the *assessment period* (three years from the date of filing the 706, or six years if the additional assets represent more than a 25 percent increase over the gross estate as it was originally reported, except in two instances; if there is fraud committed in the filing of the 706 or no 706 is filed, there is no statute of limitations), or if you need to make any other allowable change to the return, you can amend it as follows:

1. **Prepare and file another 706, typing "Supplemental Information" across the top of page 1 the form.**
2. **Attach copies of pages 1, 2, and 2 of the 706 as originally filed.**

If the return is being audited, send the information directly to the IRS office conducting the audit.

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If you don't file for an automatic extension of time to file by the due date of the return, all is not lost. You can still file for an extension of time to file if you can show *good and sufficient cause* (although there's no definition given for this phrase used in the 706 instructions, be sure to attach a statement explaining why you weren't able to apply for an automatic extension, why it was impossible or impractical to file by the due date, and why the extension should be granted), but the extension, if granted, is for no more than six months after the due date of the return.

Extension of time to pay

You may also use the Form 4768 to apply for an extension of time to pay the estate tax under section 6161 of the IRS Code (a discretionary extension of time to pay for reasonable cause), for a section 6163 election (reversionary or remainder interest), or for a section 6166 election (closely held business). We discuss sections 6163 and 6166 later.

Filing the IRS Power of Attorney and Declaration of Representative (Form 2848)

You may find it valuable to file a **Form 2848, Power of Attorney and Declaration of Representative,** with the IRS as executor or administrator, appointing an attorney, certified public accountant, enrolled agent, family member, or someone else who prepared the tax return in question to act in your behalf with regard to some or all the decedent's tax matters. Form 2848 may be filed at any time after your appointment as executor or administrator. If you file a Form 2848, be sure to attach a copy to Form 706 as an exhibit.

You may find it convenient to have someone available who can deal with the IRS in your behalf, and you can add powers not already listed on the Form 2848 or delete any you don't want to bestow. You can also rescind the power of attorney at any time. If you have different tax preparers for different types of returns, you may want to have a separate Form 2848 for each.

Keep in mind that the Form 706 contains its own version of a power of attorney, specific to that return, in part 4 under General Information. However, you can name only one person (who must be an attorney, certified public accountant, or enrolled agent), and that person can't enter into agreements with the IRS in your behalf regarding **the Form 706,** unlike a person appointed under the Form 2848, making the Form 2848 more useful to you in obtaining a 706 closing letter.

Ongoing legislative discussion proposes to limit the appointees under a Form 2848 to attorneys, certified public accountants, and enrolled agents. If and when this happens, Form 2848 will be adapted to reflect those changes, so be sure you're using the most current version of the form, which you can find at `www.irs.gov` under the "Forms and Publications" category.

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Supplemental documents

Completing the 706 may seem bad enough to you, but you probably have a pile of supporting documentation that you need to send with it. If you do, attach whichever of the following documents are applicable in your decedent's estate to the return when you file it. Consider preparing an index, or list, of exhibits. Attach the index directly behind the 706 and label each of the documents on its face as Exhibit A, Exhibit B, and so on. Using index tabs for each exhibit is also a terrific idea. Also, when referring to each of the attached documents in the 706, you can give them specific names (Exhibit A, Exhibit B, and so on) for clarity. The clearer you make things for the IRS, the happier it'll be as it reviews your tax return (and the more comfortable it'll be that you're disclosing everything)!

Among the documents to attach to the return are

- A certified copy of the decedent's death certificate (required in all cases). Chapter 5 explains how to obtain copies of the death certificate.
- A certified copy of the will, if the decedent died with a will. You obtain certified copies of the will from the court where the will was filed for probate. If you're unable to get a certified copy, attach an uncertified copy and explain why it's not certified.
- IRS Power of Attorney (Form 2848). See the sidebar, "Filing the IRS Power of Attorney and Declaration of Representative (Form 2848)," later in this chapter for more info.
- Receipt for payment of state inheritance or estate tax. See Chapter 2 and Appendix B regarding state estate and inheritance taxes.
- Appraisals of property. See Chapters 7 and 17 for more info.
- Life insurance statements (Forms 712). See Schedule D discussion in Chapter 17.
- Gift tax returns (Forms 709).
- Certificates of Payment of Foreign Death Tax (Forms 706-CE). See Chapter 17.
- Copies of trust instruments.
- For closely held businesses (see Chapter 7), earnings statements and balance sheets.

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Chapter 17 discusses when you need to attach these documents while using the individual schedules of the 706.

If the decedent was a U S citizen but not a resident, you need to attach the following additional documentation:

- A copy of the property inventory and schedule of liabilities, claims against the estate, and administration expenses as filed with the foreign court, certified by the appropriate official of the foreign court
- If the estate is subject to a foreign tax, a copy of the tax return filed under the foreign death tax act, whether estate, inheritance, succession, legacy, or otherwise
- A copy of the will, if the decedent died *testate* (with a valid will)

Completing the Form 706, Pages 1–3

If the estate you're administering requires a 706 for any reason, you must complete the first three pages, together with all the other schedules needed to report your decedent's assets, deductions, exclusions, and credits. This section helps you determine which schedules apply to your decedent's situation.



If a schedule doesn't give you enough space (and it often doesn't), attach a continuation schedule directly behind it. A *continuation schedule* is simply a blank schedule that you can use as an additional page for any other schedule in the return. One of us prepared a Form 706 with 17 pages filled with $50 U.S. Savings Bonds. A blank continuation schedule is contained as part of the 706. Make as many copies as you need.

Part 1: Decedent and Executor

On the face of the Form 706, fill in the decedent's name, address, Social Security Number, year *domicile* (residence) was established in the decedent's state of residence, date of birth, and date of death. On line 6a, list the executor you want to have contacted by the IRS; list any additional executors on an attached sheet as an exhibit and refer to it here. The rest of Part 1 is fairly self-explanatory.

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Part 2: Tax Computation

So far, so good. But now you get to start with some numbers, or so you may think. But wait — although this section is on the first page of the return, you really can't do anything with it until you've completed everything else. So, if you're just beginning, skip ahead to Part 3 (the next section). If you've completed all the other schedules and parts and are now ready to put this baby to bed, read on.

On lines 1–20, enter the figures indicated to arrive at the total transfer taxes due, if any. We highlight here anything we feel isn't self-explanatory or included in the **Instructions for Form 706 (Rev. September, 2007)** ("the Instructions").

- **Line 3:** The state death tax deduction referred to on line 3b is available if estate, inheritance, succession, or legacy taxes are paid to any state or the District of Columbia as a result of the decedent's death.
- **Line 4**: Enter *adjusted taxable gifts* (total taxable gifts made by the decedent after December 31, 1976, other than gifts includible in decedent's estate). If the gifts are includible in the decedent's estate, you've included them in the number in line 1. Use the Line 4 Worksheet TG — Taxable Gifts Reconciliation on page 4 of the Instructions. You need the decedent's 709s to complete the worksheet. Keep in mind that, besides any gifts reported on 709s, you must include any taxable gifts from prior years that you're aware of that weren't reported on 709s but should have been. To the extent that you come across gifts from earlier years in the decedent's papers that weren't reported, keep a tally year by year to see if they're taxable. The annual exclusion amount (the amount that can be gifted without incurring any gift tax) has changed over the years, so you need to look on the instructions for that particular year's 709; you can download it at `www.irs.gov` or call the IRS forms line at 800-829-3676.
- **Line 7:** Enter the total gift tax paid or payable by the decedent on gifts made by the decedent after December 31, 1976. Include gift taxes paid by the decedent's spouse for that spouse's share of *split gifts* (gifts made by one spouse that are divided 50/50 between both spouses on their gift tax returns) only if the decedent was the donor of the gifts and they are includible in the decedent's gross estate. Use the Line 7 Worksheet — Gift Tax on Gifts Made After 1976 on page 5 of the Instructions. Page 6 of the Instructions discusses split gifts further.

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- **Line 10:** Enter adjustments, if any, to the unified credit (applicable credit amount). You have adjustments only if the decedent (or the decedent's spouse, in the case of split gifts) made gifts after September 8, 1976, and before January 1, 1977, for which he or she claimed a specific exemption. If so, the unified credit (applicable credit amount) on the estate tax return is reduced. Compute the reduction by entering 20 percent of the specific exemption that was claimed for these gifts.
- **Line 13:** Enter any credit for foreign death taxes from Schedule P and attach **Form(s) 706-CE.**
- **Line 15:** Add lines 13 and 14 to arrive at the total credit. In addition to using line 15 to report the totals of line 13, credit for foreign death taxes, and line 14, credit for tax on prior transfers, you may also use it to take a credit for pre-1977 federal gift taxes under a formula laid out on page 6 of the Instructions. If you do so, be sure to identify the credit and make a note on the dotted line to the left of the entry, noting it as a "section 2012 credit." You may refer to the regulations under section 2012 for more information, but you may also want to see your tax advisor at this juncture! Also complete and attach **Form 4808, Computation of Credit for Gift Tax**.

  You may also use line 15 to claim the Canadian marital credit under the 1995 Canadian Protocol. When doing so, enter the credit on line 15 and make a note on the dotted line to the left of the entry, noting it as a "Canadian marital credit." Also attach a statement as an exhibit to the return referring to the treaty, waiving QDOT rights, and showing the computation of the credit. You can see the Canadian income tax treaty protocol for details on computing the credit, and by this point, you're probably also visiting your tax advisor!

Congratulations! Assuming you've done all the math to arrive at line 20, you've now completed the 706, which is no small accomplishment!

Signature of executor(s)

We recommend that all executor(s) or administrator(s) sign and date the return at the bottom of page 1, although only one signature is required. If none exist, the person(s) holding assets who is/are filing the return, such as the trustee(s) of a trust, sign.

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Signature of preparer other than the executor

If someone other than the person or entity signing the return above prepares the return, he or she signs the return here and completes it in accordance with the Instructions.

Part 3: Elections by the Executor

Not every election requires a campaign. In Part 3, you must decide whether to make four important elections, if they apply to your decedent and would be of benefit to your estate. Each carries with it an IRS Code section reference — as you know, the IRS never runs out of numbers! Consider each thoroughly to see whether the facts fit your decedent's estate.

Alternate valuation

Alternate valuation, which you elect on line 1, Part 3 of Form 706, is probably the most commonly used election. This election allows you to value the property of the estate, in general, as of six months after the date of death rather than as of the date of death. Using it protects the estate from paying tax on the date-of-death value of the assets if the estate's total value has dropped steeply six months after death, before the estate tax is even due. If elected, it applies to all assets; you can't pick and choose which ones to apply it to. And you can elect it only on the return as originally filed, and only if it decreases both the gross estate and the total of the estate and GST taxes. After you make the election, you can't revoke it. Finally, if you elect alternate valuation, you must still show every asset's date-of-death value.

- **Property distributed, sold, exchanged, or disposed of in any other way within six months after the date of death:** Value it as of the date of distribution, sale, or other disposition.
- **Property still in the decedent's estate as of six months after the date of death:** Value it as of that six month date. If no date in that sixth month corresponds to the decedent's date of death, use the last day of the sixth month.
- **Property that changes value due to the mere lapse of time:** Value it as of the date of death *or* as of the date it's distributed, sold, exchanged, or otherwise disposed of.

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If you elect alternate valuation, don't include increases or decreases from either the date-of-death value or the alternate value that are due entirely to the lapse of time. For example, at the date of death, a bond is worth not only the market value of the bond but also the value of *accrued* (accumulated but not yet paid) interest owed to the bondholder (the decedent) at that date. In the case of alternate valuation, only the market value of the bond changes to the value six months after death; the accrued interest on the bond remains the same as it was on the date of death. Similarly, rent accrued to the date of death on leased real or personal property of the estate goes in the gross estate, but rent accrued after the date of death does not. You include dividends that were declared to shareholders of record on or before the date of death in your alternate valuation calculations, but you don't include dividends declared after the date of death.

The exception to this last example: When dividends declared after date of death affect the number of shares of stock so that they no longer reflect the same property as they did at the date of death, include their value at the alternate valuation date for alternate valuation purposes (unless these dividends are paid from earnings of the corporation after the date of death). Although this scenario may seem fairly arcane, it happens more frequently than you may think because corporations often dilute the number of shares with stock splits, and somewhat less frequently, spinoff baby companies from the parent or issue stock dividends.

Special use valuation

The special use valuation election allows you to value real estate at its actual use rather than its highest and best use under certain circumstances (think family farm versus land for a new subdivision of mansions); you may elect to value real property the decedent owned that the decedent or a family member used in the operation of a family farm or closely held business for a certain number of years prior to the decedent's death at its farm or business use value rather than at its presumably higher fair market value, under Section 2032A of the Internal Revenue Code.



And, you even have the option of electing both alternate valuation and special use valuation with regard to the property. Because you must meet a number of conditions in order for the real property to qualify for special use valuation, you most likely want to discuss this election with a qualified tax preparer instead of tackling it on your own, both to see if your real estate qualifies and because not meeting any one condition can invalidate the election!



Electing to pay the tax in installments

If you elect installment payments, consult with a qualified tax preparer to ensure that you meet all the conditions.



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In one of the quirks of the tax code, if the estate qualifies for installment payments under Section 6166, the interest payments are deductible on **Form 1041**, despite the prohibition against deducting personal interest on income tax returns. A major difference between income tax for estates and trusts and for individuals is that you're allowed deductions on fiduciary income tax returns for expenses that you've paid solely because it's an estate or trust, even if that same expense isn't deductible on an individual return. So, even though Section 6166 interest is personal interest, similar to credit card interest, you're paying it because you elected an option available only to estates; therefore, it's deductible for income tax purposes.

Electing to postpone taxes

On line 4, Part 3 of Form 706, you may elect, under Section 6163 of the Internal Revenue Code, to postpone the tax on any future interests (reversionary or remainder) until six months after the termination of the *precedent interest* (interest which comes before the reversionary or remainder interest) in the property. And you can request a further extension of a reasonable period up to three years after the original extension for reasonable cause.

Reversionary and remainder interests are each a right to the future enjoyment of property which is being used by another at present. (See Chapter 17 for more info on these two interests on Schedule F.)

You should consider making this election if the estate will otherwise be left short of cash by paying the tax currently, and if the reversionary or remainder interest makes up a sizeable portion of the taxable estate. If you make the election, you must post a bond to the IRS for twice the amount of the tax and estimated interest.

Part 4: General Information

You only began telling the IRS about the decedent in Part 1. Now you really have a chance to fill out the picture in Part 4.

The first item under Part 4: General Information on Page 2 of the return is the authorization to receive confidential tax information, act as the estate's representative before the IRS, and make written or oral presentations on behalf of the estate. If the return was prepared by an attorney, accountant, or enrolled agent, he or she signs it and fills out all the necessary information. Remember, only one such person can be appointed here. If you want to appoint more than one, appoint someone other than an attorney, CPA, or EA; or appoint someone with the power to enter into closing agreements with the IRS regarding the estate and the 706, use **Form 2848, Power of Attorney and Declaration of Representative**, instead. (See the nearby sidebar for more information on filing this form.)

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- **Line 4:** You must complete line 4, whether or not the decedent has a surviving spouse. For no spouse, simply enter "none" in line 4a, and leave 4b and 4c blank. Otherwise, in line 4c, "Amount received," enter the amount the surviving spouse actually receives. If exact amounts aren't available, as with future interests, a *reasonable estimate* (for instance, from actuarial tables) can be used.
- **Line 5:** Include all individuals (other than the surviving spouse), trusts, and estates who receive more than $5,000 in benefits from the estate either directly (as an heir, devisee, or legatee) or indirectly (for instance, as beneficiary of an insurance policy). Don't include charities listed on Schedule O here (see Chapter 17 for more info). Include the following information about each entity:
  - Name.
  - Social Security or (in the case of a trust or estate) taxpayer identification number (TIN) in the column headed "Identifying number."
  - Relationship to the decedent in the column by that name (for example, "daughter" or "decedent's revocable trust").
  - Amount received in the column entitled "Amount." Enter the amount each person or entity actually receives; if exact amounts aren't available, use a reasonable estimate.
- If the space provided isn't large enough to include all the beneficiaries, create your own schedule based on the one in line 5 and include it as Page 5a to the return, referencing it in the schedule on the return itself.

  Underneath the individual beneficiaries is a line where you include a total for all beneficiaries who received less than $5,000 apiece and for all *unascertainable beneficiaries*. The total of all these distributions should approximately equal the gross estate less funeral and administrative expenses, debts and mortgages, charitable bequests, and federal estate and GST taxes.
- **Line 6:** Check the appropriate "yes" or "no" box to indicate whether the estate includes any qualified terminable interest (QTIP) property from a prior gift or estate under section 2044. If it does, show the assets on Schedule F. If the decedent was a surviving spouse, he or she may have received QTIP property for which the marital deduction was taken on either a 706 or a 709 from the predeceased spouse. If the decedent still retained an interest in the QTIP property as of death, it's included in his or her estate even though the interest terminated at his or her death. Chapter 17 explains how to show this info on the return.
- **Line 7:** On line 7a, indicate whether the decedent ever filed gift tax returns, and if so, attach copies as exhibits. On line 7b, list the periods covered by the returns and on line 7c, list the IRS offices where the gift tax returns were filed.

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Lines 8–16 are designed to remind you of other property that may be includible in the decedent's estate. If you aren't including it, the IRS wants an explanation.

- **Line 8**: If any insurance on the decedent's life isn't included on the return (because the insurance wasn't owned by the decedent), answer "yes" on line 8a, complete Schedule D, and attach as an exhibit **Form 712, Life Insurance Statement** (we tell you how to obtain a completed Form 712 from the insurance company in Chapter 17), together with an explanation of why the policy isn't includible in the estate. On line 8b, follow the line 8a process for any policy that the decedent owned on the life of another but isn't being included in the estate.
- **Line 9:** If the decedent held property as a joint tenant with right of survivorship, one of the joint tenants was someone other than the surviving spouse, and you're including less than the full value of the property on the return, answer "yes" on line 9 and report it on Schedule E.
- **Line 10:** Line 10a asks whether the decedent owned an interest in a partnership or unincorporated business or stock in an inactive or closely held corporation. On line 10b, you need to disclose whether you discounted the value of any of these interests for any reason. If you did take market discounts, check out the instructions for Schedule F.

  Although you're certainly entitled to take a market discount, have all your backup information organized and your ducks in a row, and be prepared for an audit. The IRS loves to audit these discounted valuations of closely held corporations.
- **Line 11:** Complete and attach Schedule G if the decedent made any transfers during life under Sections 2035 (adjustments for certain gifts made within three years of death), 2036 (transfers with a retained life estate), 2037 (transfers taking effect at death), and 2038 (revocable transfers). This line is a good place to check with your tax advisor.
- **Line 12:** On line 12a, answer "yes" if any decedent-created trusts existed at the decedent's death. Attach a copy of the trust as an exhibit. For line 12b, answer "yes" if the decedent possessed any power (such as a power to appoint a beneficiary of the trust), *beneficial interest* (interest whereby the decedent derived any benefit form the trust, such as, as a beneficiary), or *trusteeship* (decedent was a trustee of a trust) under any trusts not created by him or her. Line 12c is trying to determine whether a GST taxable termination occurred on the death of the decedent. If so (and you can find out by asking the current trustees of any such trust), as line 12d says, obtain a copy of the trust and attach it as an exhibit along with the name, address, TIN, and phone number of the trustees of that trust. Also see Chapter 17 to determine whether there was a taxable termination.







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Another good place to check with your tax advisor! On line 12e, if the decedent transferred or sold an interest in a partnership, limited liability company, or closely held corporation to a trust described in lines 12a or 12b at any time during his or her lifetime, provide the Employer Identification Number (EIN) of that entity here.

- **Line 13:** If the decedent possessed, exercised, or released a general power of appointment, complete Schedule H. A *general power of appointment* is a power to appoint the assets of a trust in favor of anyone, including the holder of the power. Look for it if your decedent is a surviving spouse; many folks use it in marital trusts for the surviving spouse because it qualifies the trust for the marital deduction. Be careful not to confuse a general power of appointment with a *limited power of appointment*, where you may only appoint in favor of certain specified people or entities, usually limited to your children, grandchildren, and other lineal heirs, and charitable organizations.
- **Line 14:** If the decedent owned, or had any interest in, a foreign bank or brokerage account, answer this question "yes." Don't be confused by foreign stock ownership — those shares of European and/or Asian companies routinely showing up in stock portfolios aren't what the IRS is asking about here.
- **Line 15:** If the decedent was receiving either an annuity described in the instructions from Schedule I or a private annuity, complete and attach Schedule I. An *annuity* is income paid in a series of payments.
- **Line 16:** If the decedent was ever the beneficiary of a trust created by a predeceased spouse for which the marital deduction was claimed, and the trust isn't reported on this 706, answer "yes" here and attach an explanation as an exhibit (for instance, the funds in the trust may have all been spent for the spouse's benefit).

Part 5: Recapitulation

Recapitulation is where you summarize the gross estate by carrying forward the asset totals from individual Schedules A through I and the deductions from Schedules J through U, all of which we discuss in detail in Chapter 17.

On line 17, enter the amount of allowable deductions, which is most likely the same amount as line 16. One exception: instances where the line 16 amount is greater than the value of the property subject to claims. In this case, enter whichever is greater: the value of the property subject to claims or the amount actually paid at the time you file the return. Unfortunately, you're not allowed to take a deduction for an amount you're not required to pay (because you don't have enough property to pay it), unless you actually do pay that amount before filing the return. Remember this rule when planning your payments of claims. Be sure to pay all deductible amounts that you aren't paying from property subject to claims before you file the return so that you can deduct them.

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Using a probate inventory as an estate tax starting point

If you're dealing with a larger estate, the probate inventory is a wonderful place to start compiling a list of the assets that need to be included on the 706. The *inventory* lists all the assets the decedent owned outright, including any real estate. Of course, the 706 also includes assets owned jointly, life insurance payments, and assets held in certain trusts, but the inventory often includes smaller items, like household furnishings, that you may otherwise forget. Check out Chapter 7 where we explain how to put together a probate inventory.

Being Ready for and Handling an Audit

Given that only estates with a relatively high asset threshold have to file Form 706, you can understand that the IRS audits a higher percentage of these returns than any other type. Assume that yours will be one of the chosen, and prepare the return and all its exhibits with that in mind. You save yourself a lot of headache that way, instead of trying to re-create what you've done six months or a year after you've filed the forms.



Keep the following pointers in mind in case the IRS comes knocking:

- **Get all the appraisals from reputable appraisers so that the results will stand up under audit.** Each appraiser should know what the IRS expects in an appraisal and should attach his or her credentials to the appraisal for the IRS to see.
- **If you take a valuation discount for closely held stock, have the calculations done by an expert in the field.** Attach them to the 706.
- **Keep a copy of every piece of paper that you use to determine an asset existed, whose name it was in, and its value.** And keep those papers in an organized file (a file broken down by schedule is one good way to do it). That way, you can lay your hands on any given piece of paper that the IRS may require at audit. Doing so goes a long way with the IRS agent conducting the audit toward feeling that you've done a thorough job and have nothing to hide.

If your return is selected for audit, you receive a letter (and sometimes a phone call) from the IRS, requesting further information, such as the decedent's income tax returns for the past few years. If that's the case, supply the information requested. Usually, the IRS accepts the additional documentation and concludes the audit. After all questions are satisfied, the IRS will issue its closing letter.



If the IRS conducts a larger audit and any issues arise, we recommend you turn to your tax expert for assistance.

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Getting an Estate Tax Closing Letter

If the IRS accepts your estate tax return as filed, or you and the IRS reach agreement as to any changes after a 706 audit, the IRS will issue **Letter 627, Estate Tax Closing Letter**. The closing letter, although not a formal agreement, shows the IRS's final determination of estate tax. The IRS isn't likely to reopen the case, but it retains the option if evidence of fraud, malfeasance, collusion, concealment, or misrepresentation of a material fact surfaces. The IRS may also reopen a case if it discovers a clearly defined substantial error based on an established IRS position existing at the time of the previous examination (basically, if it realizes it missed something it clearly should have caught), or if other circumstances exist that indicate failure to reopen would be a serious administrative omission. An executor may reopen a case if the *period for assessment* (three year from the filing of the 706, and six years from filing if unreported assets constitute 25 percent or more of the gross estate stated in the return as filed) hasn't expired. You want to do this if you subsequently discover assets of the decedent; we've certainly both had assets turn up after a closing letter was issued. You may also file a claim for refund.



Dealing with state estate and inheritance tax

As convoluted as the information in this chapter may seem, we only cover federal rules. But wait, everyone who dies lives in a state, too, and many states have either an estate or inheritance tax as well. Check out Appendix B to determine whether your decedent's state of residence has an estate tax (based on the decedent's assets), an inheritance tax (based on what each beneficiary receives), or a legacy or succession tax. Appendix B also contains addresses, telephone numbers, and Web sites for your use in contacting state authorities to obtain forms and information about any state tax.

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Chapter 17

Preparing the Estate Tax Return, Part 2

In This Chapter

- Filling out the most common Form 706 schedules
- Seeking help for all the rest

For many, preparing the **Form 706, United State Estate (and Generation-Skipping Transfer) Tax Return**, is the sterling achievement in the quest to competently administer an estate. After all, in most instances, the return is a fairly straightforward accounting of what the decedent owned and owed when he or she died. (Chapter 16 helps you with filling out the basics of Form 706.) However, if you're not completely confident after we walk through the schedules in this chapter, we suggest that you consult with either an attorney or an accountant who's knowledgeable about estate tax matters for assistance.

In this chapter, we give you an in-depth look at the schedules you're likely to take a crack at completing yourself and a heads-up on the schedules that tackle more complex areas of tax law.

Tackling the Most Common Schedules

Form 706 has a schedule for every occasion, but only rare estates have property and/or expenses diverse enough to require you to prepare every schedule. Basically, *schedules* are the places you list the individual assets, broken down by type of asset, such as Schedule A, Real Estate, and the different types of deductions, such as Schedule K, Debts of the Decedent. Still, every estate that's required to file a Form 706 must complete at least some of them. In this section, we guide you through the most commonly prepared schedules: the ones that show the types of property and the sorts of expenses you regularly find in even the smallest estates.

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Focusing on real estate: Schedule A

If the probate estate contains any real estate or interest in real estate, complete and file **Schedule A: Real Estate.** Include all real estate the decedent owned in his or her individual name or as a *tenant in common.* When title is held as tenants in common, each tenant's interest in the property is separate from the interests of the other tenants in common, and passes to his or her heirs upon death, as opposed to a *joint tenancy with right of survivorship* or a *tenancy by the entirety*, where title passes automatically to the surviving joint tenants.

For each piece of real estate, include the following information about the property on Schedule A:

- Land area.
- Any improvements such as house and lot.
- Street address.
- The legal description (the description on the deed).
- Any *accrued* rent (rent earned prior to the decedent's death but not paid until after the date of death).
- The appraisal or other basis for valuing the property. Describe the appraisal on Schedule A and attach a copy as an exhibit at the end of the return. If the assessed value reflects the market value in the area, the IRS may accept the assessed value in lieu of an appraisal. Attach a copy of the tax assessment closest to the decedent's date of death as an exhibit. If the property is sold shortly after the decedent's death, the selling price may be used. The IRS doesn't have to accept a sale price as the fair market value price, especially if the property was purchased by a related party or pursuant to an option to purchase. Attach copies of the sales contract and closing statement as exhibits.

If the decedent owned a fractional interest in real estate which you or your appraiser are discounting, attach as an exhibit a statement explaining the discount taken on the interest (due, for instance, to lack of control or lack of marketability), and be sure that the appraiser can defend the discount if the return is audited.

If the decedent was liable for a mortgage on the property (that is, if the mortgage wasn't solely chargeable against this property), report the mortgage in the property description but include the full value of the property on this schedule and deduct the mortgage on Schedule K. If a mortgage is solely chargeable against the property, so that the decedent's estate isn't liable for it, deduct the mortgage from the amount reportable on this schedule.



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Going with special valuation: Schedule A-1

If you elect special use valuation under section 2032A, valuing real estate used in the operation of a farm or closely held business at its farm or business use rather than its fair market value, as we discuss in Chapter 16, you get to complete **Schedule A-1: Section 2032A Valuation** in addition to Schedule A. Because this concept is so difficult, please consult a qualified professional to complete this schedule.



Don't forget to also include all such real estate the decedent had contracted to sell. If the contract is a purchase and sale agreement, you'll hopefully have cancelled it and re-executed it as executor because of the decedent's death (as we discuss in Chapter 20) so that you can report the real estate at its full value on this schedule and thus receive a step-up in cost basis before the sale. If you haven't cancelled the contract entered into before the decedent's death, don't include the property on Schedule A. Instead, report the contract to sell on Schedule C. If the decedent was selling property under a land contract, report the property on Schedule A, and refer to the land contract. List all jointly held real estate on Schedule E (not on Schedule A). Real estate held as part of a sole proprietorship belongs on Schedule F (not on Schedule A)

Identifying stocks and bonds: Schedule B

If the decedent owned any stocks, bonds, mutual funds, or other securities in his or her name alone at the time of his or her death, report them on **Schedule B: Stocks and Bonds,** along with any accrued but unpaid dividends or interest.

If the decedent owned any securities subject to foreign death taxes and you paid any estate, inheritance, legacy, or succession tax to a foreign country on those securities, report them on this schedule, grouped together under a heading you add titled "Subjected to Foreign Death Taxes." The following outlines what to include on this schedule.

Description

The description of each stock should include

- **The number of shares**
- **Whether it's common or preferred stock**

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- **Par value, where that's necessary for identification:** You can find the par value on the face of the certificate; it's typically only necessary for preferred stock.
- **The price per share:** We show you how to arrive at the correct value in the section "Valuation procedure" later in this chapter.
- **Corporation name**
- **Principal exchange on which the stock is sold, if any**
- **Nine-digit CUSIP number:** Every publicly traded security has this alphanumeric identifier. If you can't find it on the face of the certificate, get it from the stock's transfer agent. If the stock is in an investment account, the investment advisor can supply you with the CUSIP number.

The description of each bond should include

- **Quantity and denomination**
- **Name of the obligor**
- **Date of maturity**
- **Interest rate and interest due date**
- **Principal exchange on which the bond is sold, if any:** If you have a stock or bond that's not listed on an exchange, show the company's principal business office.
- **Nine-digit CUSIP number**

Using the Employer Identification Number rather than a CUSIP number

Whenever the gross estate includes an interest in a trust, partnership, or closely held business, you need to include the Employer Identification Number (EIN) of that entity in the column titled "CUSIP number or EIN, where applicable." That's because these entities don't have CUSIP numbers (nine-digit alphanumeric indicators) to identify them. This switch applies to whichever of the following schedules you're completing at the time: Schedule B, E, F, G, M, or O. Also include the EIN of an estate, if it has one, on these schedules where applicable.

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Valuation procedure

You report stocks and bonds on the 706 at their fair market value (FMV) as of date of death. If you're using alternate valuation (check out Chapter 16 for more specifics), you report their value as of the alternate valuation date, exactly six months after the date of death. The FMV of a stock or bond, whether it's listed or unlisted, is the *mean*, or average, between the high and low selling prices on the decedent's date of death.

If only closing prices are available, use the mean between the closing price on the date of death and the closing price on the day before the date of death. The mean is arrived at by adding the two valuation numbers together and dividing them by two. For example, the opening price of X Company's stock is $20 per share and the closing price is $22 per share. The computation is ($20 + $22) ÷ 2 = $21.

If the decedent died on a weekend, use the mean of the value on the Friday before and the mean of the value on the Monday after, and prorate the difference between the mean prices to the actual date of death, the Saturday or the Sunday. For example, assume the decedent died on Saturday. Y Company's common stock was selling for a mean of $10 per share on Friday and a mean of $13 per share on Monday. The FMV of a share of Y Company stock on Saturday is $11, computed as follows: (2 days × $10) + (1 day × $13) ÷ 3 total days = $11.

You can apply the same principle when valuing stocks or bonds with no sales on the date of death. Find the trading dates closest in time prior to the decedent's date of death and after the decedent's date of death and apply the above computation, substituting the appropriate number of days and mean value per share. The trading days must be reasonably close to the date of death. If you can't find sales reasonably close to the valuation date, use the mean between the *bona fide* bid (what a buyer says she'll pay for a stock) and *ask prices* (the seller's price to sell), if available. Stocks listed on the NASDAQ Stock Exchange are listed, and sold, by bid and asked prices rather than highs and lows for any given day, unlike those listed on the New York Stock Exchange, which lists highs and lows.

If you can obtain sales prices or bid and asked prices for before the date of death but not after, or vice versa, use the mean between high and low sale prices or the mean between the bid and asked prices on the date they're available.

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Finding values for publicly traded stocks and bonds

To find the FMV of publicly traded stocks and bonds, here are a few different options you may use to find the mean values on the decedent's date of death:

- ***The Wall Street Journal:*** You can find it at your local library if you don't have a subscription or didn't happen to save your copy from that date.
- **Internet pricing service:** If you don't have easy access to a broker, and don't want to go digging into old issues of The Wall Street Journal, you can, for a fee, access this information by using an Internet pricing service. The largest of these companies is Prudential-American Securities Inc. (`www.securities-pricing.com`), which charges $4 to price each security, with a minimum $10 fee.
- **Broker:** If the securities were in a brokerage account at date of death, the broker may be able to give you a valuation as of the date of death. Be sure that the broker understands that this value is for estate tax purposes; otherwise, he or she will give you the closing price rather than the mean of the high and low selling prices for the date of death. If you use such a broker's letter in valuing your securities, refer to it on Schedule B and attach it to your 706 as an exhibit.

Finding values for unmarketable stocks and bonds



Figuring out the value of *unmarketable securities* (securities not traded on any public exchange), including inactive stocks and stocks held in non-publicly traded corporations, is governed by rules contained in the IRS Code, as explained in section 2031 of the regulations. That statement, by itself, should be enough to send you to a qualified professional for expert assistance in preparing this valuation. Attach all information used to determine the value to the return as exhibits, including balance sheets and statements of net earnings for each of the five years before the date of death.

Securities of no value

You may very well have a decedent who owned some securities that have lost most or all of their value. If you have one or more of these obsolete securities or securities of nominal or no value, report these last on Schedule B. Include the state and date of incorporation and the address of the company, if any, and attach as exhibits copies of correspondence or statements used to determine that the security is of no value.

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Dividends and interest

On Schedule B don't forget to include dividends and interest accrued!

- **Cash dividends:** Keep three dates in mind when determining whether a dividend is due (or accrued) on a particular stock as of the decedent's date of death:
  - The *declaration date* (date the dividend is declared)
  - The *record date* (date used by the corporation to determine which shareholders receive the dividend)
  - The *payment date* (date the dividend is paid to shareholders of record)

  Include the dividend on the return if the decedent died after the record date and before the payment date. You can get this information from *Standard and Poor's Weekly Dividend Record,* or from the decedent's broker.
- **Stock selling ex dividend:** Stock sells *ex dividend* (when you purchase the stock, you also get the dividend that has already been declared, so the stock price is slightly depressed) for a few days before the record date for a dividend. If an *x* appears in the *Wall Street Journal* before the number of shares of a stock traded, you know that stock is selling ex dividend. When a stock is selling ex dividend, its price is reduced by approximately the amount of the dividend. If you have a stock selling ex dividend in your decedent's estate, add the value of the dividend to the value of the stock (the mean of the high and the low) instead of reporting the dividend separately.
- **Accrued stock dividends:** Sometimes a *stock dividend* (a dividend of shares of stock) is declared rather than a cash dividend. Report this dividend in the same manner you do a cash dividend. Commerce Clearing House's *Capital Changes Reporter* is one place to find information on stock dividends. You can also check with a broker.
- **Accrued interest:** In calculating accrued interest on a bond through the date of death, divide the number of days since interest was last paid (from the date of death) by 365. Multiply that result by the annual interest paid on the bond. The result is your accrued interest through the date of death; include this number on the 706. If a bond is selling *flat* (with no accrued interest) on the date of death, it will have an *f* after its name in the bond listings, and you don't include any interest on the 706.

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Addressing mortgages, notes, and cash: Schedule C



Report mortgages, notes, and cash on **Schedule C: Mortgages, Notes, and Cash** as follows, and in the following order. You're listing assets of the estate here, not debts, so any mortgages or notes listed here are amounts *owed* to the decedent, not owed by him or her.

- **Mortgages and notes payable to the decedent, not by the decedent.** In describing the mortgage, include the face value, unpaid balance, date of mortgage, name of maker, property mortgaged, date of maturity, interest rate, and interest date.
- **Promissory notes.** Report and describe them in the same manner as mortgages.
- **Contracts by the decedent to sell land.** Make sure that you include the following information:
  - Name of the purchaser
  - Contract date
  - Property description
  - Sales price
  - Initial payment
  - Amounts of the installment payments
  - Unpaid balance of the principal
  - Interest rate
- **In reporting cash in the decedent's possession, list it separately from cash in bank accounts.** You can aggregate all the actual cash you find; it's not necessary to list separately the cash in the bureau, the cash under the bed, and the cash hidden behind the fireplace.
- **List cash in banks, savings and loan associations, credit unions, and all other financial organizations as follows for each account:**
  - Name and address of the financial organization
  - Amount in the account, including accrued interest
  - Serial or account number
  - Kind of account (checking, savings, certificate of deposit)

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For checking accounts, be sure to report the amount in the account after you account for all those checks outstanding at the date of death. To obtain the date-of-death balances, including accrued interest, send a letter to each financial institution requesting that information (you can make up a form letter and send a variation of it to each institution), and retain the response from each in your files.

Considering life insurance: Schedule D

On **Schedule D: Insurance on the Decedent's Life,** list all policies on the life of the decedent, whether or not any policies are includible in the gross estate for estate tax purposes. Insurance which the decedent owned on someone else's life is includible on Schedule F.

Include the following insurance in the estate:

- **The full amount of the proceeds of insurance on the decedent's life receivable by the estate or usable for the benefit of the estate:** If any legally enforceable obligation on the beneficiary to pay taxes, debts, or other charges of the estate stands, regardless of who the owner and beneficiary of the policy are and who paid the premiums, it's includible.
- **Insurance on the decedent's life not payable to the estate and not usable for its benefit:** If the decedent held any *incidents of ownership* in the insurance, it goes in the taxable estate. Some examples the IRS gives of incidents of ownership are the following:
  - The right to name and change the beneficiary
  - The right to assign the policy to another or to revoke an assignment
  - The right to surrender or cancel the policy
  - The right to pledge the policy as collateral for a loan or to obtain a loan against the surrender value from the insurance company
- A *reversionary interest* in the policy if the reversionary interest was more than 5 percent just before the death of the decedent. An interest is reversionary if the decedent gains or regains any of these listed rights (such as the right to name the beneficiary) if the beneficiary predeceases the decedent or some other stated contingency occurs.

All the information you need to complete Schedule D is included on the **IRS Form 712, Life Insurance Statement,** which you must request from each life insurance company. Request Form 712 when you request the proceeds of the policy from the insurance company, as described in Chapter 7. In the

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description column, refer to the 712 as an exhibit and attach it to the return as such. If a policy on the decedent's life isn't includible, list it on this schedule, including the same information as for any other policy, but don't include a value in the value column, and do include in your description of the policy your reasons why the policy isn't includible.

Eyeing jointly owned property: Schedule E

Schedules A through D all deal with property the decedent held in his or her name alone. All of this changes in **Schedule E: Jointly Owned Property.** If the decedent held any property of any kind (including real estate, personal property, and bank accounts) jointly at the time of his or her death, you must file Schedule E, whether or not any of the jointly held property is includible in the decedent's taxable estate.



Describe the property on Schedule E in the same manner you do on its respective schedule. For instance, describe real estate as set forth in the discussion of Schedule A, bank accounts as set forth in the discussion of Schedule C, and so on. (See earlier sections in this chapter for the individual schedules.) The amount of the property includible in the taxable estate depends on the decedent's interest in the property, as we discuss in the following sections.

Part 1 of Schedule E

Part 1 of Schedule E deals with qualified joint interests held by the decedent and his or her spouse as the only joint tenants (section 2040 (b)(2)). Here you want to list all the property the decedent held with his or her surviving spouse either as joint tenants with right of survivorship (if they're the only joint tenants) or as tenants by the entirety. In either case, include the full value of the property at the date of death (and alternate valuation date, if applicable). These properties are qualified joint interests under section 2040(b)(2), which provides that, if property is held by the decedent and his or her spouse as joint tenants with right of survivorship (with no other joint tenants), or as tenants by the entireties, only one-half of the property is includible in the gross estate. (***Note:*** Legally, only husband and wife can hold property as tenants by the entirety.)



You may only claim the special treatment under 2042(b)(2) and list the property on Part 1 if the surviving spouse is a U.S. citizen. Otherwise, include the property on Part 2.

Total the values of the properties on line 1a, and include one-half of the value of the properties on line 1b. The amount on line 1b is the amount includible in the gross estate.

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Part 2 of Schedule E

Part 2 focuses on all other joint interests. Under 2a, list the names and addresses of all other surviving joint tenants. If you have more than three joint tenants, create a continuation sheet.

In completing Part 2, enter the letter corresponding to the surviving joint tenant's name and address in the second column. In the third column enter the property description, and in the column entitled "Percentage includible," enter 100 percent unless you can show that

- Part of the property originally belonged to the surviving tenant or tenants and wasn't acquired by gift from the decedent
- Part of the property was acquired with funds that came from the surviving joint tenant or tenants
- The property was acquired by the decedent and the other joint tenant(s) by gift, bequest, devise, or inheritance.

If you can prove any of the above, you may exclude an amount proportionate to what the surviving joint tenant(s) have contributed to the property from the gross estate.



Giving up the right to dower, curtesy, or other marital rights (see Chapter 2) in the decedent's estate doesn't count as contributing toward the joint property in this instance.



If you aren't including the full value of the joint property in the gross estate in Part 2, (which, of course, you're usually trying not to do so as not to increase the decedent's gross estate) be sure to attach as an exhibit proof of the extent, nature, and origin of the interests of the decedent and the other joint tenants for each such property.

Considering other property: Schedule F

Schedule F: Other Miscellaneous Property Not Reportable Under Any Other Schedule is that handy place to put everything that just doesn't go on any other schedule. If the decedent owned it, here's the place to put it.

Examples of items that are reported on Schedule F include

- **Personal and household articles, including clothing and jewelry:** If the decedent owned any works of art or collectible items worth more than $3,000 or any collections whose combined value exceeds $10,000, attach an appraisal by an expert in the field as an exhibit to the return. Your appraiser will need to attach a statement of his or her qualifications.

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You may ask, "How will I know if the value of the decedent's collection of frog figurines is worth over $10,000, or if one of them is worth over $3,000?" If you have any suspicion that an item may have some value, have it appraised. We had a client whose frog collection was worth far more than $10,000. And one of us had a client whose highly touted stamp collection just didn't get the, well, stamp of approval from the appraiser. So even we don't always know what we have until we get an expert's opinion. We discuss how to find an appraiser in Chapter 4.



If the decedent transferred ownership of an item to his or her revocable living trust during life as part of his or her estate plan, you don't need to include it on Schedule F. If that's the case, you report the item on Schedule G.

- **Automobiles and all other motor vehicles:** Book value or a letter from an auto dealer (or whatever other type vehicle) is usually sufficient. If your decedent had a collectible car, get an expert appraisal.
- **Debts (other than notes and mortgages reported on Schedule C), judgments, claims, and refunds due the decedent:** When the decedent and a surviving spouse receive a tax refund on a jointly filed return, the amount you include on the 706 as the decedent's portion of the refund is the excess of the amount the decedent paid of the total tax paid over his or her actual tax liability (unless local law says the contrary, in which case you want to consult a local attorney or tax preparer who's an expert in these matters).
- **Checks payable to the decedent, whether received before or after death:** These include final paychecks, dividend checks, and any other checks.
- **Rights, royalties, and leaseholds:** If the decedent held copyrights or other rights, received royalties, or had a *leasehold* (an extended right to lease property), obtain expert valuations and include them here.
- **Farm products, growing crops, livestock, and farm machinery:** If the decedent owned a farm, you'll likely have some or all these items to report, all of which can be valued by a competent farm appraiser.
- **Insurance on another person's life:** Be sure to obtain Form 712 for each policy from the insurance company and attach it as an exhibit to the return. The Form 712 gives you the value of the policy as of the decedent's date of death. See our discussion of Form 712 under Schedule D earlier in this chapter.
- **Interests in partnerships, sole proprietorships, joint ventures, and other unincorporated businesses:** Value these interests as described in the Instructions to Form 706 (Rev Sept 2007) (the Instructions). If you have a sole proprietorship that holds real estate, report the real estate here, as part of the sole proprietorship, rather than on Schedule A.

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- **Reversionary and remainder interests:** You report both reversionary and remainder interests on Schedule F. As we discuss in Chapter 16, you may elect as the executor to postpone the tax on these future interests under Section 6163 until six months after the prior interest terminates, with a further extension of up to three years for reasonable cause.
  - A *reversionary interest* is any future interest which can come back to the decedent where he or she was the original transferor of the interest. For instance, the decedent has retained a reversionary interest in the trust property if during lifetime he or she transferred property to a trust for the benefit of his or her mother for her lifetime under the condition that it revert back to the decedent upon the death of the mother.
  - Meanwhile a *remainder interest* is any future interest that can come to the decedent after a prior interest terminates where the decedent wasn't the original transferor of the interest. For instance, if the decedent's father created a trust with the decedent's mother as the beneficiary during her lifetime, and the decedent or his or her estate is to receive the property upon the death of the mother, the decedent has a remainder interest in the trust.
- **Qualified terminable interest property (QTIP).** If your decedent was a surviving spouse, he or she may have qualified terminable interest property (QTIP) received from a predeceased spouse. The predeceased spouse received a marital deduction for the trust, either on his or her estate tax return or a gift tax return. If such an election was made, and the surviving spouse (your decedent) still retains an interest in the property at his or her death, the full date-of-death (or alternate) value of the property shows up in his or her estate even though his or her interest terminates at death. If the QTIP property meets the other requirements for the marital or charitable deduction on the surviving spouse's death, it qualifies for that deduction because it's treated as having passed from the surviving spouse (your decedent). See Chapter 3 for an explanation of the QTIP trust.



Report the fact that the decedent had a safe-deposit box on Schedule F, Question 3. If any property in the safe-deposit box isn't includible in the decedent's estate, you must explain fully why that's the case.

Touching on funeral and administration expenses: Schedule J

All the **Form 706** schedules up to Schedule J deal with the decedent's assets. With **Schedule J: Funeral Expenses and Expenses Incurred in Administering Property Subject to Claims**, you're finally beginning the portion of the tax

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return where you take every last deduction you can on behalf of the decedent (except those you may elect to take on the estate's income tax return. Check out the sidebar "Options for where to take your deductions: No double dipping" for more info.)

On Schedule J, you include funeral expenses and expenses incurred in administering property subject to claims. The phrase *property subject to claims* refers to property available to pay the decedent's creditors. Your local (state) law will determine which property is subject to claims. Include on Schedule J each separate expense, itemizing each with the name and address of the person or entity to whom or to which the expense is payable, and the nature of the expense.



Keep in mind that, generally speaking, administrative expenses must be deductible under state law and be considered "reasonable and necessary" by the IRS for them to be deductible on the 706. What's reasonable and necessary? There's no set standard; rather, it's more a sense of knowing it when you see it. If the 706 you've prepared is audited, though, be prepared to substantiate your expenses with receipts, and where necessary, with a scope of the work that's been performed. The IRS loves nothing more than slicing off a portion of the executor's fee as being excessive.

Although the deduction is limited to the amount allowable under local law, it also can't exceed the total of the value of property subject to claims in the gross estate and the amount of expenses paid out of property included in the gross estate but not subject to claims.



Don't deduct expenses of property not subject to claims on this schedule! Those expenses are properly deducted on Schedule K. If you can't determine the exact amount of certain expenses by the time the Form 706 is due, estimate as accurately as you can.

Funeral expenses

Itemize all funeral expenses on line A, Schedule J. These expenses include all miscellaneous items billed by the funeral home (such as death certificates); flowers; a newspaper funeral announcement; a tombstone, monument, mausoleum, or burial plot for the decedent and his or her family (including perpetual care costs); and travel expenses for one person to accompany the body to the place of burial if traveling a distance.



Unless that amount is paid to the surviving spouse, reduce the funeral expense deduction by any amounts you receive from the Social Security Administration (currently, and for many years past, $255) or from the Veterans Administration (VA). Remember the fifth grade? Show your math right on Schedule J!

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Options for where to take your deductions: No double dipping

Although many expenses of the estate are only deductible on Form 706, you actually have three options for taking some deductions. If you have the option of deducting an expense on different tax returns, think about which deduction benefits the estate the most. Remember, with a couple of notable exceptions listed here, you can't *double dip* — that is, take a deduction for the expense on both the 706 and an income tax return. The three options are as follows with some important relevant info about each one:

- Form 706
- The estate's Form 1041
- The decedent's final Form 1040

When deciding where to take the allowable deductions, compare the tax rates on the 706 and the 1041. If you're paying an estate tax, that rate is almost always higher than any trust or estate income tax rate, so you want to take the deduction on the estate tax return. But if you have to file a 706 due to the size of the estate and will owe no tax (perhaps due to an unlimited marital deduction, discussed under the Schedule M section later in this chapter), you want to capture that otherwise-unused deduction on a 1041.

How do you decide where to deduct the expenses? The following list shows you some of your options:

- **Expenses deductible only on Form 706:** Funeral expenses and debts of the decedent that wouldn't have been deductible on a 1040 of the decedent if paid before death.
- **Expenses deductible on both Form 706 and either final 1040 of the decedent or the estate's 1041 (a double dip, go for it!):** Real estate taxes assessed before death but not paid, and other taxes deducible for income tax purposes, interest, and business expenses accrued at the date of death (these are known as "deductions in respect of the decedent") can be taken both on Schedule K and on the estate's Form 1041 or the decedent's final Form 1040.
- **Expenses deductible on only one or the other of the decedent's final 1040 or the 706:** Medical expenses incurred at date of death but not yet paid may be deducted on either Form 706, Schedule K or Form 1040, Schedule A, but not on both. Remember, medical expenses are only useful as an income tax itemized deduction when they exceed 7.5 percent of the decedent's adjusted gross income (AGI). If the decedent is filing jointly with his or her surviving spouse, the 7.5 percent AGI calculation is based on their combined income, not just the decedent's.
- **Expenses deductible only on whichever of the 706 or the estate's or trust's 1041 paid the expense:** Administration expenses and losses (including expenses of sale that will offset the sale price of property). Note that selling expenses are only deductible on the 706 if the sale is necessary to pay debts of the decedent, administration expenses, or taxes; preserve the estate; or carry out distribution.

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If your decedent was a veteran and the VA provides a burial marker, you don't have that expense to deduct. Although deducting the cost of the funeral luncheon (also referred to as the *collation*) has been common practice, a tax court case recently disallowed such a deduction in Michigan. Whether this ruling will apply beyond the specific facts of that case remains to be seen, so you may want to hold off on deducting that post funeral feast until the tax court issues further rulings.

Administration expenses

On line B of Schedule J, list the administration expenses for your executor commissions, attorney fees, and accountant fees, indicating whether they're amounts estimated, agreed upon, or paid. If you don't have a probate estate, enter the amount of the trustees' fees of the revocable (now irrevocable) living trust on line B1. If both executors' and trustees' fees are being charged, enter the trustees' fees as a miscellaneous expense under item B4. If the decedent arranged to pay the executor through a bequest or devise, you can't deduct the payment.



We strongly recommend that you fill in, sign, and date **Form 4421, Declaration of Executor's Commissions and Attorney's Fees** (available on line at `www.irs.gov`), reference it on line B1, and attach it to the 706 as an exhibit. This action expedites the audit process. Form 4421 contains a statement as to how much of the attorney fees and executor fees are being taken as a deduction on an income tax return.

Other expenses you may deduct on Schedule J include

- Appraisers' fees
- Probate court filing fees
- Certified copy charges and the like
- *Guardian ad litem* fees (see Appendix A for a definition of this unusual species)
- Brokers' and auctioneers' fees (but only if the sale was necessary to pay taxes, debts, or expenses of administration, to preserve the estate, or to effect distribution of the property)
- Maintenance expenses of estate property (including insurance)
- Investment advisors' fees
- Other miscellaneous expenses related to the estate such as telephone bills, mileage, and postage

Even interest expenses you incur as executor after the decedent's death are deductible if they're reasonable, necessary to the administration of the estate, and deductible under local law. But if you elect to pay the estate tax in installment under section 6166 as we discuss earlier, you can't deduct any interest expenses incurred on the installments on the 706. Don't forget about them, though — you can deduct them on the estate's Form 1041.

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Recording debts, mortgages, and liens: Schedule K

List your Schedule K items under the following two categories:

The decedent's debts

Report all unsecured debts of the decedent that existed at the time of the decedent's death, whether or not *mature* (currently due), and that relate to property not subject to claims of the decedent's creditors. As we discuss for Schedule J in the previous section, your state law determines which items of property are subject to claims and therefore whether you deduct these expenses on Schedule J or K. For each item, include the name of the creditor, the nature of the claim, and the amount. If the claim is for services for a certain period of time, state that period of time.

Examples of some deductible debts are

- Household expenses, such as utility bills, accrued before death
- Property taxes accrued before the decedent's death
- Federal taxes on income received before the decedent's death (or the decedent's portion [the amount for which the estate would be liable under local law], if it's a joint liability with a surviving spouse)
- Unpaid gift taxes on gifts the decedent made
- Certain claims of a former spouse against the estate if they meet the requirements set out in the instructions to Form 706, Schedule K
- Professional fees, such as attorneys' fees, accountants' fees, and so on, for services rendered during life
- Amounts due on notes, judgments, and accrued interest through date of death

Mortgages and liens

On the bottom half of Schedule K, report only obligations:

- Secured by mortgages or other liens for which the decedent was personally liable (and for which the estate is liable)
- On property you included in the gross estate at its full value, unreduced by the mortgage or lien

If the decedent and his or her estate aren't liable for the mortgage or lien, include in the gross estate only the value of the property net of the debt. You don't deduct any portion of such debt on this schedule.

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Listing net losses and such: Schedule L

Although you certainly try to avoid shipwrecks or other disasters during your term as executor, you may find comfort in the fact that you can at least deduct them if they occur during the settlement of the estate. Also deductible are losses from theft, fire, storm, and other casualties, except to the extent they're reimbursed by insurance or in some other manner and the loss isn't reflected in the alternate valuation of the property. You may not take the loss on the 706 if you elect to take it on the applicable income tax return, so take a look at your relative tax rates and make your best choice.

Deduct the expenses you incur in administering property included in the gross estate but not subject to claims on the bottom half of **Schedule L: Net losses during administration and expenses incurred in administering property not subject to claims.** Here's where you report the expenses relating to administering a decedent's revocable trust (funded with assets before death, and, of course, irrevocable after death). You may only deduct those expenses paid within the period of limitations, typically three years after the 706 is filed. The expenses must relate to settling the decedent's interest in the property or vesting good title in the beneficiaries. Any expenses deducted on an income tax return may not be deducted here. Report the expenses in the same fashion as those on Schedule J.

Covering bequests to surviving spouse: Schedule M

If your decedent left a surviving spouse, you may have a whopper of a deduction available to you, which you report on **Schedule M: Bequests, etc. to surviving spouse.** All property that passes to the surviving spouse as a result of the decedent's death qualifies for the unlimited marital deduction, provided that the surviving spouse is a U.S. citizen. Using the unlimited marital deduction causes no tax to be due on the death of the first spouse to die; when the second spouse dies, his or her estate pays whatever tax is due on the remaining assets of both spouses. Therefore, if your decedent left a surviving spouse, that spouse's estate (not your decedent's) will be responsible for the tax burden, and you can breathe a sigh of relief. The following sections highlight which property does and doesn't qualify for the marital deduction.

Property qualifying for the marital deduction

Property qualifying for the marital deduction includes assets held either solely in the decedent's name or jointly with the surviving spouse. In addition, the following items also qualify:

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- **Trust qualifying for marital deduction:** Property left in trust for a surviving spouse qualifies for the marital deduction if, under the trust agreement, the surviving spouse at a minimum is the sole beneficiary, is entitled to receive all the income for his or her life, can withdraw any or all of the principal at any time, and has a general power of appointment exercisable by will.
- **Life insurance, endowments, and annuity contracts:** Proceeds from these assets, if payable to the surviving spouse, qualify provided that they meet all the conditions laid out in the **Form 706** instructions.
- **Qualified terminable interest property (QTIPs):** Check the will and any trusts carefully for a QTIP trust. If one exists, you may either elect to claim a marital deduction for qualified terminable interest property by listing the property on Schedule M and deducting it (that's all it takes to elect it), or elect out of the QTIP, and thus not get a marital deduction. In either case, list the property on Schedule M. If you're choosing not to use the QTIP election (to elect out), be sure to specifically identify the trust as being excluded from the election. Remember, any property for which the election is made will be included in the decedent's spouse's estate when he or she dies. When would you choose to elect out? When the surviving spouse's estate is much larger than the decedent's, and you don't want to increase it further and take it to a higher tax bracket. Of course, when you elect out, even though the property is listed on Schedule M, you may not include it in the total and take it as a marital deduction.

  Consult your tax advisor to be sure you meet all the requirements for making a valid QTIP election!



- **Joint and survivor annuities:** If your decedent has a joint and survivor annuity with his or her surviving spouse, that spouse doesn't have to specifically elect to take the marital deduction for that property. If the surviving spouse has the right to receive payments during his or her lifetime after the decedent's death, that constitutes a QTIP election unless you, as executor, affirmatively opt out of the election on the 706, for the reasons described earlier.
- **Charitable remainder trusts:** If you have a surviving spouse who receives an interest in a *charitable reminder trust*, it isn't treated as a nondeductible terminable interest if the interest passes from your decedent to his or her surviving spouse and that surviving spouse is the only beneficiary of the trust (other than charitable organizations). A charitable remainder trust is either a *charitable remainder annuity trust* or a *charitable remainder unitrust* — Chapter 3 tells you what you need to know about these trusts.
- **Qualified domestic trusts (QDOTs):** A surviving spouse who isn't a U.S. citizen doesn't automatically qualify for the unlimited marital deduction unless the property is put into a qualified domestic trust (QDOT) for the benefit of that spouse.



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The terms of the QDOT are quite specific, and you want to consult with a qualified tax advisor if you need to follow this route. If the decedent left a marital trust that doesn't meet the requirements of a QDOT, you can ask the probate court to reform the trust so that it qualifies for the election. If your decedent left assets not in a trust to the surviving spouse, the spouse or you (as executor) may establish a QDOT trust. The surviving spouse can then transfer assets left outright to him or her into this trust.

As an alternative to attempting to meet the QDOT requirements, the surviving spouse may elect to become a U.S. citizen, although chances are he or she would have done so by now.

Property not qualifying for the marital deduction

A *terminable interest* is an interest that terminates or fails after the passage of time or upon the (non)occurrence of some contingency. In general, terminable interest property received by a surviving spouse is normally nondeductible. It makes sense, because the IRS isn't able to collect estate tax on property when the surviving spouse dies if the interest terminates beforehand. As usual, you have a couple of exceptions:

- **Six-month survival period:** If your decedent left a bequest, whether outright or in trust, to the surviving spouse on the condition that the spouse survives for a period not exceeding six months, it's not considered a terminable interest, and so will qualify for the marital deduction. Many estate plans contain this condition.
- **Deductions against the marital deduction:** If you claim a deduction as executor on Schedules J through L against any property you take as a marital deduction, you must reduce the amount of the marital deduction by that J through L deduction amount. If the marital deduction property has a mortgage or other encumbrance, you may take only the net value of the property after you deduct that mortgage or encumbrance.

Recording charitable, public, and similar gifts and bequests: Schedule O

Don't worry, you haven't missed anything here — Schedule N was eliminated years ago. So just proceed to Schedule O to claim a charitable deduction if your decedent left a bequest, legacy, devise, or transfer for a qualified charitable purpose to any qualified charitable organization. See the Instructions for Form 706 regarding Schedule O for the five general categories of qualified charitable organizations.

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Presuming survival with simultaneous death

If both your decedent and his or her spouse die in a common disaster (an occurrence we sincerely hope doesn't arise) and the order of their deaths can't be determined, review each spouse's estate planning documents to see if they assume that the spouse with the smaller estate survived the other spouse. In both the husband's and wife's documents, the presumption would be that the spouse with the smaller estate survived. Thus, the spouse with the smaller estate would inherit marital deduction property from the wealthier spouse, which the spouse with the smaller estate could then use his or her exemption amount against, making full use of both spouses' exemption amounts. If no such presumption is made in the estate plan documents, or if you can't find any such documents, state law governs. In at least some states, each decedent is presumed to have survived the other, thus leaving no marital deduction and perhaps no or less than full use of the exemption amount by the spouse with the smaller assets. (Refer to the discussion of exemption amounts at the beginning of this chapter.)



You may take an estate tax charitable deduction for amounts transferred to charitable organizations as a result of a *qualified disclaimer*. A qualified disclaimer is a refusal to accept an interest in property under certain, very specific circumstances (see Chapter 8). Consult your tax expert to be sure you have crossed all your t's and dotted all your i's to qualify for this disclaimer. In addition to disclaimers, the instructions for Schedule O list other types of property which qualify for the charitable deduction.



If you have any questions about a charitable gift made by your decedent, or about how to report the gift, consult that estate tax expert we keep mentioning.

Knowing When to Ask for Help

Although a reasonably competent person can prepare most of **Form 706** without professional help, some of its schedules involve complex areas of tax law. In this section, we give you what you need to know in order to identify whether any of this property or these expenses are in your estate, but we strongly suggest that you not rely on your own common sense to work your way through reporting these items. Many technicalities here can turn these schedules into a minefield for the unwary.

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Listing transfers during life: Schedule G

Welcome to **Schedule G: Transfers during Life,** the land of the look-back, the second glance, the "if only," the "oops, I really wish the decedent hadn't retained that power," and, quite probably, the "I think I'd better check with my tax expert about this schedule. . . ."



If the decedent transferred property during his or her life for less than full payment, sometime it can be included in his or her taxable estate. Sometimes the decedent knew the property would be included in the estate (when, for instance, he or she funded a revocable trust during life — revocable trusts and the property held in them are always included in the decedent's estate and are reported on Schedule G). Occasionally (we hope not often) a power over a transfer the decedent made during life is retained unintentionally, causing the property transferred to be includible in the decedent's estate. In either case, or any other that may arise, Schedule G is here, courtesy of the IRS, for your convenience in reporting certain transfers made within three years of death, including gift taxes on gifts made within three years of death (even though the gifts may not be includible in the estate) and transfers with certain retained interests.

Exercising powers of appointment: Schedule H

A *power of appointment* over property, which can be either general or limited, is the power to decide who will be the ultimate owner (or have the enjoyment) of the property and when. It's usually created by someone other than the decedent under that person's will or trust, giving the decedent the authority to direct the use and dispersal of any property controlled by the power. For example, Abe X leaves a trust under his will to his wife, Ida X, and gives her a general power of appointment over all the property contained in the trust. When Ida X dies, her executor must include this power on Schedule H of Ida's Form 706, listing all the property that was in Abe's trust on the date of Ida's death.

Only property controlled by a *general power of appointment* is included on **Schedule H: Powers of Appointment.** A *general power* can be exercised in favor of anyone, including the decedent, his or her estate, his or her creditors, or the creditors of the estate. A *limited power of appointment* can only be exercised in favor of a limited class of people designated by the grantor (for instance, the grantor's children and their lineal descendants), never including the power holder, his or her estate, his or her creditors, or the creditors of his or her estate.

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Considering annuities: Schedule I

The term *annuity*, for estate tax purposes, is an agreement to make periodic cash payments to one or more persons over a specific period of time. An annuity is subject to estate tax if payments (or a lump sum payment) continue after the decedent's death. If the annuity ends with the decedent's death, it's not includible in the decedent's estate. On **Schedule I: Annuities,** report the value of any annuity that meets the requirements set out in the Instructions.

Claiming a credit for foreign death taxes: Schedule P

You may claim a credit for foreign death taxes paid to a foreign country or any of its political subdivisions on **Schedule P: Credit for Foreign Death Taxes** if the decedent is a U.S. citizen or a resident alien, on property situated in the foreign country, and subject to estate tax on the 706. To obtain the credit, the foreign tax must be a tax on the transfer of the foreign property at death. You may also claim a credit for foreign death taxes under death tax treaties or conventions with many countries. Check the Instructions for **Form 706-NA, United States Estate (and Generation-Skipping Transfer) Tax Return (Estate of nonresident not a citizen of the United States)**, for a current list of treaties in effect.

Getting a credit for tax on prior transfers: Schedule Q

Whoever said the IRS didn't have a heart was wrong. In **Schedule Q: Credit for Tax on Prior Transfers,** you're allowed a credit for estate taxes paid by a prior estate on property included in this estate, provided the transfer from the first estate to your decedent happened no more than ten years prior to or two years after your decedent's date of death. The property needn't exist on your decedent's date of death. Property qualifies for the credit if it was subject to estate tax on the prior decedent's (the transferor's) date of death. You may take the credit so long as your decedent was considered the beneficial owner of the property, even if that ownership ended with your decedent's death, such as a *general power of appointment* (see Schedule H earlier in this chapter for a definition of a general power of appointment), annuity, life estate, term for years, and *remainder interest* (whether vested or contingent).

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Generation-Skipping Transfer Tax: Schedule R

The Generation Skipping Transfer (GST) tax assesses a tax on property at each generational level as if it had been owned by someone of that generation, even though ownership of the property skipped over one or more of those generations. Its purpose is to prevent grandparents from leaving property to grandchildren, bypassing the children in between to bypass taxation in the children's estates.



As executor, you want to know enough about the GST tax to recognize whether your decedent's estate may be subject to it. If you've already made that determination, or if you're fence sitting because you're not sure, it's time to call in the experts — be they estate attorneys, accountants, or EA's — to prepare Schedules R and R-1 and to help you determine who are the skip beneficiaries, and what property, exactly, those beneficiaries are receiving. Remember, only assets that skip generations (even if the property lands in a trust for the benefit of a skip person) are subject to the GST tax.

Electing a Qualified Conservation Easement Exclusion: Schedule U

If your decedent's gross estate includes land which is subject to a *qualified conservation easement*, you may make an election to exclude a portion of the land which is subject to the easement from the estate. For the purpose of Form 706, a *qualified conservation easement* is defined as an *easement* (an easement allows others to use your land for a specific purpose) of a qualified real property interest to a qualified organization exclusively for conservation purposes. After it's made, the election can't be revoked. An easement can also be granted after the decedent's death.

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Chapter 18

Filing Income Tax Returns for a Decedent, Estate, or Trust

In This Chapter

- Applying for a Taxpayer Identification Number
- Deciding when the decedent's tax year should end
- Determining the decedent's (and the estate's) income
- Calculating deductions
- Tackling Page 2 of Form 1041

Life would be great, or certainly comforting, if all income tax returns were alike, and for the most part, they are. There are differences between preparing (and filing) your own **Form 1040** and the decedent's, which you still must file in order to report income and deductions, up to and including the date of death. And those differences become even more pronounced after you move into income taxation of estates and trusts, where some concepts remain the same, but others change.

In this chapter, you discover what's the same, and what's different, with both the decedent's final Form 1040 and the trust or estate's **Form 1041.** We tell you how to stay in the clear with the IRS as you prepare the final year (or maybe two) of the decedent's personal income tax returns (Form 1040), or you complete and file income tax returns for estates and trusts (Form 1041).

Before You Begin: What You Need to Do

Thinking about income taxes may not be high on your list of priorities as you begin administering an estate or trust, but it will soon become a main focus of your administration, whether you're thrilled by the idea or not. Planning for those first income tax returns should begin right away, not at year-end when the first deadline for filing is fast approaching.

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This section helps keep your tax reporting running as smoothly as possible. We discuss obtaining a federal tax ID number and choosing an appropriate tax year-end. By the time you finish this section, you'll be ready to jump right in.

Obtain a federal tax ID number

Before you get started on any tax return, you need to have a federal taxpayer identification number (or TIN). If you're preparing the decedent's final Form 1040, just use his or her Social Security Number (or SSN).

However, if you're thinking ahead to filing that first return for the decedent's estate or for a trust, you need a TIN before you can begin. Apply for the estate or trust's TIN by using **Form SS-4, Application for Employer Identification Number,** which you can get from any IRS office, by phoning 800-829-4933, or online at `www.irs.gov/businesses/index.html` (click on "Employer ID Numbers" to go directly to the form). When applying by phone or online, you receive your number immediately; if you file a physical application by mail, it takes up to ten days to receive the form from the IRS, and up to an additional four more weeks to receive the number itself.

Every taxpayer needs a TIN. Although individuals use their SSN, estates and trusts must each have their own EIN in order to file any tax returns. You're not allowed to use the decedent's SSN to file an estate return, nor can you use the estate's EIN to file a return for a trust that inherits the estate's property. Still, obtaining a TIN only costs you a little time and no money, so don't feel like you're being wasteful because you're not able to recycle ones that are no longer useful, like the decedent's SSN. Be careful, though, and only apply for a TIN once for each taxpayer; nothing is worse than trying to sort out the confusion with the IRS and your banks, brokerages, and anyone else to whom you've given the information, when an estate or trust has more than one EIN.

If you need to open even one bank or brokerage account for an estate, you have to apply for a TIN to do so. Applying alerts the IRS that a new trust or estate exists; it's going to expect tax returns from that entity, even if there's no obligation to file one. Not to worry — if you receive a notice asking for a tax return, send the IRS a letter explaining that the estate didn't have enough income to file. Or, to avoid the notice altogether, you can prepare and file a return showing no income (which we show you how to do in this chapter).

Choose a tax year-end

Although Congress created a general rule in 1986 that all individuals, businesses, and most trusts had to use December 31 as their tax year-end, every rule has exceptions. An estate may choose the last day of any month as its tax year-end, provided the first year doesn't include more than 12 months.

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Why choose a date other than December 31 as a tax year-end? Depending on how much income the estate stands to receive (and when), using a different year-end can substantially reduce the total income tax bite, especially if the estate's administration will take more than 12 months from start to finish. If you haven't already, create a schedule of when and how much income you expect the estate to receive. Because estates and trusts reach the highest tax bracket very quickly, we recommend that you split the initial flow of income into two years, if possible. Whether the estate is paying the tax, or distributions to the beneficiaries means they'll be responsible for the income tax bill, splitting income into two years can ease the overall income tax burden for both the estate and the heirs.

You'll be asked to declare a year-end when applying for the trust or estate's EIN, but your decision isn't absolutely final until you file that first income tax return and put the year-end on the top of page 1. For example, the decedent died on April 15, and you initially chose a December 31 year-end because you didn't know that you could choose differently. The estate paid large, tax-deductible expenses before December 31, but ended up receiving the majority of its income in January and March of the following year. If the tax year-end remains December 31, the first tax return has no tax due and misses out on large deductions (because it has no income to offset them), while the second year's return will show lots of income, few deductions, and a large tax bill. By changing the year-end to January 31 (which is still less than twelve months after the decedent died), you can move some income back into the estate's first tax year — hopefully enough to offset the deductions — and drastically reduce the amount of taxable income in the second tax year. You've reduced not only the income tax due on that return but also the total amount of income taxes paid by the estate over the course of administration.

If you choose a year-end other than December 31, you're responsible for correctly accounting for all income received because the 1099s you receive from banks, brokerages, and others may not accurately reflect income for the tax year; only your good recordkeeping will produce an accurate tax return.

Calculating the Income

Whether you're filing a Form 1040 or a Form 1041, your first task is to determine how much income the taxpayer (whether trust, estate or decedent) earned. In the case of an individual (filing Form 1040), you're already likely familiar with the types of income you'll see, like wages, retirement income, interest, dividends, capital gains, rental income, and so on. Not surprisingly, types of income on Form 1041 are the same (although you see wages, pensions and Social Security, railroad retirement, or veteran's benefits rarely, because these payments tend to stop at death). All you need to do is identify the income, put it on the correct line, and add the total. This section walks you through the different types of income you need to know how to figure.

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Interest

Interest is income you receive because you've lent money. No matter where or to whom you lend money, either to banks, the U.S. Treasury, state and local governments (municipal bonds), corporations, foreign governments, or your nephew Fred, the income earned from that investment is interest.

With the exception of interest you earn when making personal loans, **Form 1099-INT** should tell you how much interest you're dealing with. Just add up all the Form 1099-INTs to get the year's total. For non-calendar-year filers, remember that using 1099 information may cause you to either over- or under-report income. Make sure you keep excellent records to make up for this discrepancy. You report total taxable interest on line 1 of Form 1041, or line 8a of Form 1040. You show *exempt interest* (interest not subject to federal income tax, like interest from municipal bonds) on the back of Form 1041, on Question 1 of "Other Information"; if you're preparing the decedent's final 1040, place his or her exempt interest on line 8b.

Dividends

Unlike interest, *dividends* represent profits from a company in which you own shares. You can earn dividends from publicly traded or closely held corporations and from U.S. or foreign companies. You may receive them from specific corporations or from shares owned in a *mutual fund,* which buys and sells the shares of many corporations, giving you tiny pieces of each individual dividend. Regardless of the source, every January you receive a **Form 1099-DIV**, showing how much you earned from dividends.

The most common types of dividend payments shown on Form 1099-DIV are the following:

- **Total dividends:** *Total dividends* are the total amount of ordinary dividends you received. Add these numbers up from all Forms 1099-DIV and place the total on line 2a of Form 1041 or line 9a of Form 1040.
- **Qualified dividends:** As a portion of the total dividend, *qualified dividends* are subject to lower income tax rates. If you've received more than one Form 1099-DIV, and each has an amount listed in box 1b, add all amounts shown in box 1b, and place the total on line 9b of Form 1040 or split between lines 2b(1) and 2b(2) of Form 1041. Chapter 19 tells you how to make the allocation between the two lines.
- **Capital gain dividends:** *Capital gain dividends* are payments you received, primarily from mutual funds, that derive from the sale of assets within the fund and that are subject to a lower income tax rate. You typically place

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the amounts shown in box 2 of Form 1099-DIV on Schedule D (for either a Form 1040 or a Form 1041); however, if you're preparing the decedent's Form 1040 and he or she had no other capital gains or losses, check the box next to line 13 of Form 1040, and then fill in the amount.

Business income

Business income is income received from operating a business, one that the taxpayer owns either wholly or only in part, like a shareholder in a Subchapter S corporation. If the decedent operated a business as a *sole proprietor* (he or she was the owner of the company and declared his or her business income on Schedule C of Form 1040; check out Chapter 7 for more info), you probably have to prepare a Schedule C to file with both the final Form 1040 and with the estate's Form 1041, at least while you're wrapping up the affairs of the business. After you complete Schedule C, place the total on line 3 of Form 1041, or line 12 of Form 1040. If income is received from a Subchapter S corporation or a partnership, you receive a Schedule K-1 from that entity's income tax return, reporting all the types of income you need to include on either the decedent's Form 1040 or the trust or estate's Form 1041; only include on the business income lines of these tax returns amounts labeled as *ordinary income* on Schedule K-1.

Although paying self-employment tax after a person dies may sound strange, income earned from a sole proprietorship declared on Form 1040 is still subject to that additional tax. Don't forget to prepare and include Schedule SE with the decedent's final Form 1040. After the business is operating under the estate's ownership, self-employment tax disappears. Evidently, someone got the memo that the estate would never collect Social Security or Medicare.

Capital gains and losses

We know you love definitions, so here are a few useful ones to help you calculate the capital gains and losses. *Capital property* is anything that is owned by an entity that is used to generate income, income that may be earned either during the course of ownership or when the property is sold. A *capital gain* is the profit earned when a piece of capital property is sold for more than its acquisition cost (otherwise known as *basis*), while a *capital loss* recognizes the difference between a low sales price and its higher basis. Although there's a difference between property held for personal use and capital property in an individual's life (which is why you don't need to report the gains and losses you receive from your annual yard sale), trusts and estates don't use hairdryers and tableware, so all property owned by a trust or estate is capital property, and all gains and losses realized on their sale must be accounted for on Schedule D of Form 1041.

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Whenever you sell property, the difference between your basis in the property and the sale price determines the capital gain or loss. In order to figure out what number to use on line 4 of Form 1041 or line 13 of Form 1040, you need to know not only these numbers but also the acquisition dates and sale dates of all property sold. Proceeds from sales and sale dates will be easy to sort out, because you receive **Form 1099-B** for the sale of all securities and **Form 1099-S** for the sale of a house.

If the sale dates and proceeds are easy to find, figuring out what acquisition costs and dates and numbers to use can sometimes be confusing. And if that's not bad enough, you also have to calculate the *holding period,* or the length of time the entity's owned the property. Here, you have a choice between the following:

- **Long-term gain or loss** (property owned for more than one year)
- **Short-term gain or loss** (property owned for one year or less)
- **Inherited property,** which automatically is treated as long-term, even if the estate or trust has only owned it for a day or less

Table 18-1 shows which ones to use.

Table 18-1 Determining Acquisition Costs and Dates

Tax Form	*Acquisition Method*	*Basis Cost*	*Acquisition Date*	*Holding Period*
1040	From decedent's estate	Date of death value (or alternate valuation*)	Date of decedent's death	Long-term
	Purchased	Purchase cost	Trade date of purchase	Long-term, if held for more than one year
1041 (estate)	From decedent's estate	Date of death value (or alternate valuation*)	Date of decedent's death	Long-term
	Purchased	Purchase cost	Trade date of purchase	Long-term, if held for more than one year

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Tax Form	*Acquisition Method*	*Basis Cost*	*Acquisition Date*	*Holding Period*
1041-Revocable trust funded during grantor's lifetime	From grantor	Grantor's acquisition cost	Grantor's acquisition date	Long-term, if held for more than one year after grantor's acquisition
	Purchase	Purchase cost	Trade date of purchase	Long-term, if held for more than one year
1041-Irrevocable Trust	From grantor during life-time	Grantor's acquisition cost	Grantor's acquisition date	Long-term, if held for more than one year after grantor's acquisition
	From grantor after death	Date of death value (or alternate valuation*)	Date of grantor's death	Long-term
	Purchased	Purchase cost	Trade date of purchase	Long-term, if held for more than one year

**Alternate valuation is determined 6 months after date of death, and must be elected on the decedent's Form 706. See Chapter 16.*

Just because the decedent's estate isn't large enough to warrant filing a **Form 706** doesn't mean that the value of his or her property doesn't benefit from the so-called *step-up* or increase in basis. Unless the decedent dies in 2010, the basis of the property the decedent owned at death changes to the date of death value, and the new acquisition date is the decedent's date of death. For example, John Smith owns XYZ Corp stock he purchased for $50 per share in 2003. At his death in 2008, the stock was now worth $100 per share. Even though Mr. Smith doesn't have a taxable estate, the acquisition cost for his XYZ Corp shares is now $100 per share. When his executor sells the shares for $100 each, no gain or loss is recognized, because the sales price equals the stepped-up acquisition cost, so no capital gains tax is due on the sale.

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Income from rents, royalties, partnerships, and other estates and trusts

If the decedent, estate, or trust owned rental property, had an interest in any mining activities, published any works (or had an interest in published works), was a member of a partnership, or was a beneficiary of another estate or trust, you're going to have to fill out **Schedule E, Supplemental Income and Loss.** The good news: Whether you're preparing Form 1040 or Form 1041, Schedule E is the same.

Part I of Schedule E covers the income and/or loss from rental and royalty income; Part II gives you space to show the same information from Partnerships and S Corporations; and Part III wants to know about any income from other estates or trusts that you may have to report on this return.

In addition to being the collection point for information on all these types of income, Schedule E is also the spot where you need to decide whether the income you received is active or passive. Basically, you need to determine whether the participant actively participated in the business or was merely an investor (not involved in the day-to-day activities of that business). If you're preparing a Form 1041, the answer to this question is fairly simple — trusts and estates are rarely active participants in partnerships and S corporations, and rental and royalty income is, by definition, passive, so the income and/or losses from these activities are almost always passive. If you're filing a 1040 return for the decedent, the distinction isn't always so clear-cut. Check out the most current version of *Taxes For Dummies* by Eric Tyson, Margaret Atkins Munro, and David Silverman (Wiley) to determine whether you're dealing with active or passive income.

Whether you're filing a Form 1040 or Form 1041, if you have passive losses you may deduct them only against passive income; passive losses that exceed passive income are suspended. Calculate your passive loss limitations on **Form 8582, Passive Activity Loss Limitations**.

Farm income or loss

If the decedent owned a farm, the land doesn't just disappear because he or she has died. The farm will continue operations, at least until you can find someone to buy or lease the property, and you'll need to report any income or loss from it. Before you can fill in a number on line 6 of Form 1041 or line 18 of Form 1040, you're going to have to wend your way through Schedule F. Fortunately, Form 1041 doesn't have a separate Schedule F, so after you figure out how to prepare one, you can easily transfer those skills from the decedent's Form 1040 to the estate or trust's Form 1041.

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Ordinary gain or loss

If your decedent owned any sort of business property (from real estate owned as part of a business to office equipment, cars, or any other property that had a business use), when you sell it you're going to report that sale on **Form 4797, Sale of Business Property.** Use Part I to report sales of property held long term by the decedent, trust, or estate and Part II for short-term sales. ***Note:*** Property that an estate or trust acquires due to the decedent's death constitutes an inheritance, uses the date-of-death value for its acquisition cost and date of death for its acquisition date, and qualifies as a long-term holding, even if the sale occurs the day after the decedent died.

Like Schedule D, Form 4797 needs a description of the property sold, acquisition and sale dates, and the taxpayer's cost of acquisition. Table 18-1 earlier in this chapter explains how you determine the acquisition date and basis cost for property. In addition to this information, if the property *depreciated* over time (where the property's value is recovered over its useful economic life), you must add the total amount of depreciation to the sale price in order to calculate the gain or loss. Look at the decedent's prior years' income tax return to see what property he or she was depreciating. If there's no sole proprietorship (Schedule C), rental property (Schedule E), or farm (Schedule F), you're off the hook in regards to depreciable property. If any of those schedules are attached to a prior return, you may want to consult a tax expert for assistance in determining how much, if any, of the depreciation taken must be recaptured. If it sounds something like caging a wild animal, well, you're not too far off the mark.

After you complete Form 4797, carry the short-term gains or losses from line 17 of Form 4797 to Form 1041, line 7. If you're filing the decedent's Form 1040, follow the instructions for line 18a and b. Some of your losses may end up on **Schedule A, Itemized Deductions**; gains and other losses not reported on Schedule A end up on Form 1040, line 14. Long-term gains or losses take a detour through Schedule D (1041, line 10 or 1040, line 11) so that you can factor these long-term sales into your tax calculations.

On Form 4797, you also report *casualty losses* (which are losses from a theft, or a disaster, such as a fire, flood, or earthquake), and the gain or loss received on *installment sales* (where you receive the proceeds from the sale over a period of years, not all at once) and on *like-kind exchanges* (where you exchange one piece of property for another, similar piece of property). Casualty losses, installment sales, and like-kind exchanges are very technical transactions, and you may want to consult an attorney, an accountant, or an enrolled agent before either entering into one or attempting to report the one you've already participated in to the IRS.

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Dividing income and deductions between the decedent and the estate

One of the most perplexing questions facing an administrator or executor of an estate is how, exactly, to divide income and deductions between the decedent's final Form 1040 and the estate's Form 1041. Does the decedent continue to pay tax on investment income until the assets are reregistered in the name of the estate? Where do you deduct mortgage interest payments and real estate taxes? What about back wages paid after death?

Just because an employer, bank, brokerage firm, or other payer continues making payments to the decedent doesn't necessarily mean that's the tax return where they should go. You make the final determination of where these items rightfully belong, and you have the responsibility of reporting them correctly.

Because most taxpayers are *cash basis* (you report only items that you've actually received or paid out, not items that you owe or others owe to you), you should be able to determine pretty easily which tax return an item belongs on. If a check is dated after the date of death, it belongs to the estate, even if it's payable to the decedent; checks dated up through the date of death belong to the decedent, even if the decedent hadn't yet cashed them. The same is true for amounts owed by the decedent. If the decedent wrote and mailed the check, he or she gets the deduction; if you pay the bill after death, the deduction belongs to the estate, even if you paid the check out of the decedent's checking account (which is a major no-no we discuss in Chapter 8).

As with any rules, exceptions exist. Property owned *jointly with rights of survivorship* (a form of joint ownership in which title passes automatically to the surviving joint owner(s)), and property owned as *tenants by the entireties* (a form of ownership available only to spouses in which title passes automatically to the surviving spouse on the first spouse's death) transfer at the time of death to the surviving owner(s), so income received after death belongs 100 percent to the surviving joint owner(s) or surviving tenant by the entirety. Likewise, mortgage payments owed on property held jointly with rights of survivorship and as tenant by the entireties become the sole responsibility of the survivor(s). If property is owned *jointly as tenants in common*, the scenario changes. At death, the heirs of the deceased joint owner become additional joint owners of the property and are now automatically entitled to the decedent's share of the income (and the decedent's share of the debts owed on that property stays with the decedent's share of the property which goes to the heirs).

The estate often receives income for months — sometimes years — after the decedent's death, with checks still payable to the decedent personally. Don't hesitate to deposit these checks into the estate's accounts — that's where they belong, after all. You have to notify the IRS, however, that the estate is going to declare this income. You can do this by completing and filing a nominee **Form 1099** with the IRS, showing the decedent (with his or her Social Security Number) as the Payer, and the estate (with its TIN) as the Recipient. Because these are optically scanned forms, you can't use the samples on the IRS Web site, but they're usually available for free from any IRS office during tax season. You can also get them by mail by calling 800-829-3676 (IRS Forms), and you receive them within ten business days, or you can buy them in January or February from any stationery or office supply store if you're willing to buy a large quantity. If you've failed to file nominee 1099s, you can still let the IRS know where the income you're reporting was originally reported to them. Merely place a notation on the estate's tax return showing that the estate received the

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income in the name and Social Security Number of the decedent. Ideally, if you use this method, you should also file a dummy Form 1040 for the decedent, showing the receipt of the income, and then offsetting payments to the estate, making sure to include the estate's TIN.

Other income

You've already figured out that you need to declare all income whether it falls into any of the categories already described in this section or not, and you need to pay any income taxes owed on it. Line 8 of Form 1041 (Form 1041, line 21) is where you put those items that defy description, the ones that you can't possibly squeeze into any of the categories already listed. While on Form 1040, popular "other income" items include fees and honoraria and jury duty pay, on Form 1041, the most common item will be taxable state income tax refunds. If the trust or estate is a party to a lawsuit (either its own, or as a successor to the decedent), place any taxable awards received here.

Finally, although most itemized deductions are equally deductible on a Form 1040 or Form 1041, you may only deduct medical expenses on Form 1040, and not on Form 1041. If, in the course of administering the estate, you pay final medical bills for the decedent, you don't need to lose those deductions. The IRS allows even cash-basis taxpayers to deduct medical expenses paid within a year after death on the decedent's final Form 1040.

Deducing Deductions

Although the rules governing deductions are generally the same whether you're filing a tax return for an estate or trust or one for the decedent, some differences do apply. After all, how interesting would the world be if all rules were absolute? This section gives you the lowdown on taking deductions on the two different tax forms.

For some inexplicable reason, itemized deductions for Form 1041 are included on the front of the form; for Form 1040, you have to go to Schedule A, Itemized Deductions. Check out the most recent version of *Taxes For Dummies*, by Tyson, Munro, and Silverman, for the current line on how to fill out Schedule A.

Interest

Whether you're responsible for filing a Form 1040 or a Form 1041, the following types of interest are deductible:

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- Interest paid on a mortgage that is secured by real estate (including interest on home equity lines of credit)
- Interest that you pay for a stock margin account

Personal interest paid on such things as credit card debts, unsecured loans, or unpaid tax bills is never deductible.

But wait! This rule has an exception, too. If you elect to pay the estate tax under Section 6166 (that's an election to spread out the payment of the estate taxes owed over a ten-year period), you get to deduct that interest on Form 1041, even though it's interest on an unpaid tax bill. Why? Even though it's so-called *personal interest,* it's also an interest payment that arises only because you're dealing with an estate (or a *successor-in-interest trust*, which receives the assets of the estate after estate administration is complete). You can deduct expenses the estate or trust incurs for being an estate or trust; the fact that only an estate or trust can pay Section 6166 interest overrides the rule that personal interest is nondeductible.

Taxes

Generally speaking, taxes in a trust or estate refer to real estate taxes and state and local income taxes. Although individuals also have the option of deducting state and local sales taxes instead of income taxes, that option doesn't exist in the estate/trust environment. We think the IRS has figured out that estates and trusts aren't out there buying consumer goods, but that's only a guess on our part.

Just as you get to do on Schedule A, you can deduct the actual amounts you paid as taxes during the estate or trust's tax year on line 11 of Form 1041. Remember, you get the deduction only for amounts you actually paid, so don't include estimated taxes you paid in the first month of the following tax year. However, pick up your fourth quarter estimated tax payment from the prior tax year if you paid it in the current year. Also, if you applied an overpayment from last year's return to this year's, pick up the overpayment not only as income (if you deducted it in the prior year) on line 8 of Form 1041 but also as a deduction on line 11.

Fiduciary fees

If you're doing all this work out of the goodness of your heart, you can skip right over line 12 of Form 1041. But if you've figured out that the amount of work involved in administering this trust or estate is so much that you really need to be paid, this point is where you deduct your fee for services, called fiduciary fees.

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Fiduciary fees (the amounts executors, administrators, or trustees charge for their services) are generally fully deductible. But if some portion of the income for the estate or trust comes from municipal bonds or other tax-exempt vehicles (tax-exempt money market funds, for example), you're required to allocate fiduciary fees between taxable and tax-exempt income, and you get to deduct only the amount allocable to taxable income. To calculate the allocation, subtotal the income shown on lines 1 through 8 of Form 1041 and add the tax-exempt income from line 1 in "Other Information" on the back of the return to arrive at total income. Divide the total income by the total taxable income and multiply the results by the total fiduciary fees. You take the deductible fees on line 12 and subtract the balance from the total tax-exempt income to arrive at the *adjusted tax-exempt income.* Place that number on Schedule B, line 2.

For estates, you probably want to base the executor's fee you charge on the number of hours you actually work on estate matters. Set a rate that you feel your time is worth, and keep careful track of your time. See Chapter 9 for a further discussion of how to arrive at an executor's fee. For trusts, if you're making the investment decisions, you may want to obtain a fee schedule from a trust company, which charges its trust clients a percentage of the market value of the assets it holds, plus a percentage of income collected, as its fee. Your fee shouldn't exceed that of a bank or trust company, and it probably will be less, because your overhead is much less. If you're paying an outside advisor for investment advice, you'll most likely want to subtract his fee from the one the bank or trust company charges; after all, investment advice is already included in the fee he charges.

Charitable deductions

The rule concerning charitable deductions is fairly straightforward. You can't give away money from an estate or trust to charity, no matter how good the cause, unless the decedent's will (or the trust instrument) tells you to. Because this rule is absolute, you don't often see charitable deductions on an estate or trust income tax return. You're not even allowed to take a deduction for the contents of the house or the decedent's clothes that you gave away to Goodwill unless the decedent directed you to do that under his or her will.

If the terms of the decedent's will direct that you give a percentage of the estate (or, for particularly generous decedents, the whole shebang) to charity, you calculate the charitable deduction on Schedule A, located on the back of Form 1041. Other times, charitable deductions can occur when the trust or estate owns a partnership or S corporation interest, and that entity gave to charity. Since the decision to give wasn't yours, you may take the deduction.

Frequently, donors establish trusts with either whole or partial charitable interests, and fund them either by gifts made before death, or from their estates after death. These trusts may either be set up as private foundations,

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or as *charitable lead* (or remainder) *annuity trusts,* or *Unitrusts*. In most cases, these trusts don't file a Form 1041, and the returns they do file (**Forms 5227** or **990-PF**) aren't for the faint of heart. If you're named as trustee for one of these types of trusts, get an attorney, accountant, or enrolled agent experienced with these returns who can assist you in tax preparation. Strangely enough, most tax professionals don't prepare these sorts of returns, so be sure that you find someone who has the expertise you need. Check out Chapter 3 for a description of each of these types of trusts.

Attorney, accountant, and preparer fees

Although Schedule A of Form 1040 limits deductibility for attorney, accountant, and return-preparer fees, Form 1041 allows you to fully deduct these fees (which are miscellaneous itemized deductions limited to amounts more than 2 percent of adjusted gross income). If you have tax exempt income on question 1 of the "Other Information" section on the back of the 1041, you have to split the fees between taxable and tax-exempt income, and are only allowed to deduct the portion attributable to the taxable income. For details on how to allocate between taxable and tax-exempt income, look at "Fiduciary fees" earlier in this chapter. After you add your fees, and allocate when necessary, place your deduction on line 14 of Form 1041.

Miscellaneous itemized deductions

If you've run out of specific categories but still have some things you suspect you can deduct, lines 15a and 15b of Form 1041 are where you need to be. Just like Schedule A of Form 1040, some of these miscellaneous itemized deductions (which include fees for investment advice, security fees that your broker may charge you, or safe deposit box fees) are subject to the so-called *2 percenthaircut* (you can only deduct amounts that are greater than 2 percent of adjusted gross income); others aren't, such as the amount you spend on postage and making photocopies. Remember, the general rule that expenses that are incurred only because this is an estate or trust are fully deductible, while fees that anyone in the position of looking after investments would pay are subject to the 2 percent exclusion. The following sections outline the miscellaneous itemized deductions you can make.

Deductions not subject to the 2 percent floor

More likely than not, many of the miscellaneous itemized deductions are subject to the 2 percent floor. So which ones aren't subject? Because the estate isn't likely to have gambling losses (at least it better not have — otherwise, you may be in trouble with more people than just your corner bookie), impairment-related work expenses of a disabled person, or unrecovered investment in a pension, you may be wondering what, if anything, you can deduct on line 15a of Form 1041. The answer is simple.

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Avoid double-dipping deductions

Chapter 17 tells you that many of the deductions available on the Form 706 are the same as ones listed in this chapter, and you may be wondering if you can have it both ways, deducting them the first time on the 706 and then again on the 1041. Well, you can't. In fact, the IRS refers to this practice as *double dipping* and seriously frowns upon it.

So choose. When you have an estate that owes estate tax, compare the tax rates for the estate tax and the income tax (the estate tax is almost always higher), and take the deductions on the return that is paying a higher rate of tax. On the other hand, if you must file a 706 but won't owe any estate taxes (perhaps because of a surviving spouse and an unlimited marital deduction), deduct only things like funeral expenses and debts of the decedent (which aren't deductible on the 1041) on the 706. Include all estate administration costs on the 1041.

As with every rule, the double-dipping rules have a couple of exceptions. Real estate taxes that have been assessed but not paid as of the date of death are a valid debt of the decedent on Form 706, but as the estate pays them, they also become an income tax deduction available to the estate. And medical expenses billed after death are a debt of the estate on the 706, but you can include them on the decedent's final Form 1040 as a medical deduction. Just to let the IRS know that you haven't double dipped, you must attach a signed statement that any deductions taken on the estate's Form 1041 haven't been taken on the estate's Form 706.

Any expense the trust or estate has incurred only because of its trust or estate status is deductible here. So if you're dealing with a law firm that charges for every copy and stamp it uses on your behalf, the deduction for miscellaneous costs goes here. So do filing fees for the probate court, publication costs for the newspaper ads ordered by the probate court, and the premium for *surety bonds* (a type of insurance policy indicating that you don't intend to abscond with the funds).

Deductions subject to the 2 percent floor

Line 15b of Form 1041 is the place for all other miscellaneous deductions: Investment advice, safe deposit box rentals, service charges on dividend reinvestment plans (DRIPs), and travel expenses. Payments to obtain duplicate stock certificates go here. So do costs to purchase your own supplies (stationery, stamps, and the like).

Unless the trust or estate didn't make any distributions to beneficiaries during the year, determining the 2 percent you have to exclude is a tricky, circular calculation. Because you can't find a computer tax-help program for Form 1041 preparation, you probably want to hire a tax professional to assist you if you have lots of deductions subject to the 2 percent floor. As a practical matter, if you only have minor deductions here and you feel otherwise equal to the task of preparing the Form 1041, leaving those deductions off may be easier; the tax benefit to the trust, estate, or income beneficiaries will be far less than the cost to have the return professionally prepared.

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Calculating the Income Distribution Deduction (Schedule B)

Unique to the world of trusts and estates is the concept of the Income Distribution Deduction **(Schedule B).** When trusts and estates pass out payments of income to beneficiaries (as opposed to payments of specific property called for under the will or the trust instrument), those payments carry income tax consequences for the trust or estate *and* for the beneficiaries. The trust or estate receives a deduction, and the beneficiaries must include the amount deducted from the Form 1041 on their individual Form 1040. Form 1041, Schedule B synthesizes all the info you've compiled to this point into the all-important *income distribution deduction*.

Although Schedule B may look intimidating, it's really not so bad. Just follow these steps (unless the trust or estate is in its final year):

1. **Take the total from line 17 on the front of Form 1041 (line 1).**
2. **Add that total to the adjusted tax-exempt interest, which is nothing more than total tax-exempt interest less fiduciary and other fees allocated to it (also known as the contents of line 2).**
3. **Enter the net capital gain (flip your tax return to its front, and place the number you see on line 4 onto Schedule B, line 6 on the back).**
4. **Subtract that number from your total of Schedule B, lines 1 and 2, to arrive at the *distributable net income* (DNI), or the total amount that could possibly be taxed to the beneficiary if the world were perfectly round and all the planets were aligned.**

If you're preparing the return for an estate or simple trust, you can ignore Schedule B, line 8. If yours is a complex trust, though, and you're either not required to distribute all income or you distributed more than just income, you need to calculate *trust accounting income* (TAI). To calculate TAI, add lines 1 through 8 from the front of Form 1041 and the tax-exempt income from line 1 of "Other Information" on the back of Form 1041. Subtract capital gains or losses (line 4, Form 1041) and all fees and expenses that you charged against the income earned in the trust. Exclude fees and expenses charged against principal (including whatever fees you paid from the capital gains) when calculating TAI, and don't allocate any of the income fees you've paid between taxable and tax-exempt income.

On Schedule B, line 11, you put the total amount of distributions made from the estate or trust to beneficiaries during the tax year. These amounts may be mandatory, such as in the case of a simple trust, where all income must be distributed in the tax year that you're preparing the return for. In this case, one of three scenarios may apply:

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- If you're required to distribute all, or any part, of the trust's income, no ifs, ands, or buts, place the amount you're required to pay to the beneficiary (even if you didn't actually pay it) on line 9.
- Any amounts of income you paid to the beneficiary at your discretion, but that weren't mandated by the trust instrument, belong on line 10.
- The total of lines 9 and 10 belongs on line 11.

On line 12, calculate what portion of that total distribution came from tax-exempt income. If you distributed 100 percent of the income, place the number you have on Schedule B, line 2. If you distributed less than 100 percent, calculate the percentage of income you did distribute, and then multiply that percentage by the amount on Schedule B, line 2. Subtract line 12 from line 11 to arrive at line 13, Schedule B.

The income distribution deduction is an either/or calculation, and now that you've calculated *either* (line 13), you need to also arrive at *or* (line 14). This part is much easier — just subtract line 2 of Schedule B from line 7 and place your answer on line 14. Compare lines 13 and 14. The smaller of the two is the income distribution deduction. Place your answer on line 15, Schedule B, and then carry the result to line 18 on page 1 of Form 1041.

Calculating the estate tax deduction

Very often, an estate has, as an asset, the right to receive items of income on which income tax has yet to be paid. If the estate is large enough to pay an estate tax, those income items (called *Income in Respect of Decedent* or IRD) are taxed twice — once on the transfer of property (estate tax), and the second time on the receipt of income (income tax). Of course, this double taxation on the part of Congress is grossly unfair and expensive and completely uncalled for. Congress, to its credit, has recognized this problem and instituted the estate tax deduction.

The types of IRD that most commonly trigger the estate tax deduction are pensions and IRAs, final wages, and the sale of property (either due to an ongoing installment sale or because the decedent dies after the purchase and sale agreement is signed, but prior to the actual property transfer).

If you're administering a large estate and have paid an estate tax, you may be entitled to a deduction on the estate or trust's income tax return (on Form 1041, line 19) for the portion of estate taxes paid on these IRD items. You determine this deduction by calculating the estate tax based on the value of the total estate, including IRD, and then calculating it a second time on the value without IRD. The difference in the two calculations is the amount of estate tax paid on that piece of income; this is the amount of your deduction. Chapter 16 walks you through the estate tax calculation. After you've done it twice (once with IRD, and once without), you'll be a pro at it.

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Paying estimated taxes

The income tax system is a pay-as-you-go endeavor. That's why the government withholds income taxes from some people, and others make quarterly estimated payments. But you'll find exceptions in the world of trusts and estates:

- After someone dies, he is no longer responsible for making estimated tax payments on individual federal returns. If the decedent's final individual return is joint with his spouse, only pay estimated taxes on the spouse's income, not on the decedent's.
- Because of all the early confusion associated with a new estate (and because you can scarcely determine what the income will be in an estate that's just beginning), the government doesn't require you to file federal estimates for the first two years of an estate's existence. If you're dealing with a trust that's essentially operating as the estate, the same two-year federal exemption applies.

For all other trusts, the pay-as-you-go plan is in place. If you fail to make your estimated tax payments, you'll be charged a penalty for underpayment of estimated taxes. Although the sun still rises when this slip-up happens (and these things often fall through the cracks, especially at first), you never want to cough up extra dollars to the government when you don't have to.

Finally, keep in mind that these are federal rules; state rules may be different. Check with the tax authority in the state where the estate or trust is resident to determine your state's rules.

Computing the taxes owed

No matter which tax return you're preparing (the decedent's personal return or one for an estate or trust), you have to calculate the tax after you figure out the income and the deductions. If you're working on the decedent's return, you arrive at your tax liability exactly the same way as you would your own (check out the latest version of *Taxes For Dummies,* by Tyson, Munro, and Silverman, for current tax rate tables and information on Schedule D and the AMT). If you're finishing up a Form 1041 and need to figure out Schedule G (on the back), read on. The following is a list of the different types of tax computations you may need to perform before you can put the finishing touches on the tax return you're preparing.

Ordinary tax computation

You can find tax rate tables for estates and trusts, which change every year, in the Form 1041 instructions for that year, which you can locate at `www.irs.gov` under "Forms and Instructions."

One reason why many executors, administrators, and trustees choose to make distributions to beneficiaries is that the government taxes estates and trusts very heavily on ordinary income. For example, in 2007, ordinary income for

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estates and trusts of more than $10,450 was taxed at 35 percent (the top rate), while an individual's Form 1040 would have to show $349,700 of ordinary taxable income before paying tax at the 35 percent rate in that same year. By making distributions, you pass that taxable income to the beneficiaries, who are, most likely, in a lower tax bracket, reducing the total amount of tax paid.

Capital gains and qualified dividends computation

No matter whether you're filing a tax return for an individual, a trust, or an estate, capital gains and qualified dividends are taxed at special, fixed rates; you calculate these taxes on the worksheets attached to Schedule D. Even though the worksheet looks intimidating, all it does is strip out the various types of capital gains property and apply the correct tax rate to those gains. If you have any entries on Schedule D, or you have qualified dividends, taking a few minutes with this worksheet can save you big bucks because you pay far lower rates on most capital gains and qualified dividends than you do on other types of income. For example, a trust with $22,000 total income, of which $12,000 is ordinary income, and $10,000 is a long-term capital gain, would pay $6,743.50 in tax if there were no preferential capital gains tax rate, but will actually pay only $4,743.50 ($3,243.50 tax on ordinary income, and $1,500 tax on long-term capital gains), a $2,000 tax savings.

Whether you calculate your tax by using the worksheet on the back of Schedule D or the tax rate table, place the total tax on taxable income on line 1a of Schedule G, Form 1041.

Tax on lump-sum distributions

Sometimes, through no fault of your own, the estate you're administering is saddled with the payout of the entire balance of an employer's qualified retirement account (see Chapter 7), which shoots the estate's income tax liability through the roof. If the decedent was born prior to January 2, 1936, his or her estate may be eligible to use ten-year averaging and/or 20 percent capital gains rules when calculating the taxes owed, which may result in substantially lower taxes than if you calculated the taxes in the ordinary way.

Prepare these special calculations on **Form 4972, Tax on Lump-Sum Distributions**. Instructions for this form are included with the form, which is available from `www.irs.gov`. Just look for it under "Forms and Instructions." After you finish Form 4972, you place the taxes on lump sum distributions on line 1b of Schedule G, Form 1041.

Alternative minimum tax

Since 1986, every trust and estate has been required to do the alternative minimum tax (AMT) calculation, even if the trust or estate isn't subject to the AMT. (The *AMT* is a flat tax designed to prevent certain high-income individuals, estates, and trusts from not paying any, or enough, income tax.) And, like

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the AMT calculations found on Form 6251 for individuals (see the current edition of *Taxes For Dummies,* by Tyson, Munro, and Silverman), the fiduciary calculation is also a bear.

You can find the AMT schedule (all 4 parts and 76 lines) for trusts and estates on pages 3 and 4 of Form 1041, under Schedule I. Using the following list, which gives you the basics about each part, you should be able to prepare this with a little patience. You can find the line-by-line directions in the **Form 1041** instructions, available at `www.irs.gov` under "Forms and Instructions."

Part I: Estate or Trust's Share of Alternative Minimum Taxable Income

1. **Take your adjusted total income from page 1, line 17 and add back any interest, taxes, or miscellaneous itemized deductions subject to the 2 percent (Form 1041, line 15a) you've previously deducted; subtract any income tax refunds included as income on line 8.**

   Among other frequent AMT add-back items are interest from private activity bonds, net operating losses, and AMT adjustments from other estates or trusts. Check the line-by-line instructions for a complete list.

2. **Add the beginning adjusted total income to your adjustments. Put the total on line 25, adjusted alternative minimum taxable income.**

3. **Finally, subtract the income distribution deduction from Schedule I, Part II, line 44, and the estate tax deduction (Form 1041, line 19).**

   If your total comes to less than the exemption amount (which you'll find on line 29 of Schedule I), you're finished! This estate isn't subject to the AMT this year. If your total is more than the exemption, keep going.

Part II: Income Distribution Deduction on a Minimum Tax Basis:

If you made distributions to income beneficiaries during the year, you need to complete this part, whether or not the trust or estate is subject to the AMT.

1. **Refer to the section "Calculating the Income Distribution Deduction (Schedule B)" earlier in this chapter to review this calculation.**

2. **Redo the calculation, taking into consideration that your starting point is different and that you may have less tax-exempt interest, in which case your adjusted tax-exempt interest may be different.**

   Remember, private activity bond interest is taxable for AMT purposes.

Part III: Alternative Minimum Tax:

Lines 45 through 56 are where you actually calculate the additional tax, if any, that the trust or estate has to pay due to the AMT. Go carefully through these lines; although the instructions for the calculation are clearly printed on Schedule I itself, you can easily make a mistake, especially if you're preparing the form manually.

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Part IV: Line 52 Computation Using Maximum Capital Gains Rates:

Lines 57 through 76 mirror the calculations you already made on the back of Schedule D so that capital gains continue to receive preferential tax treatment. Once again, the instructions are on the face of the return. Be careful not to mix up line numbers (one of us is famous for putting the right answer on the wrong line), as this is one form you don't want to prepare twice.

If you're unfortunate enough to have a number on line 56 of Schedule I, the trust or estate owes this additional tax. Copy the amount on line 56 onto line 1c of Schedule G, Form 1041.

Credits

After you put the sum of lines 1a through 1c on line 1d of Schedule G, you're ready to see whether you can reduce your tax with tax credits. Tax credits are dollar-for-dollar amounts that you subtract from your tax liability; they're much better than deductions. Estates and trusts aren't eligible for most of the tax credits individuals can take, and no credit on Form 1041 can reduce the tax liability below zero.

However, on lines 2a through 2d of Schedule G, you have the opportunity to reduce the trust or estate's tax liability with the following credits:

- **Foreign tax credit:** You're entitled to take a credit for taxes you've paid to a foreign country with whom the U.S. has a tax treaty (which is almost everywhere, with a few exceptions like Iraq, Iran, and North Korea). If the amount of foreign taxes paid is $300 or less, you can just fill in the amount actually paid on line 2a. However, if the amount is greater than $300, you have to become acquainted with **Form 1116, Foreign Tax Credit.** The IRS understands that this form is evil (which is why they allow you to skip it for relatively small amounts), and it estimates that it should take you about seven hours to complete. If you made income distributions to beneficiaries during the year, you should allocate the applicable portion of the foreign tax credit to the beneficiary as his or her percentage share of the total income.

  Form 1116 has been known to bring even the most brilliant accountants to their knees. If you need to attach one of these forms to your return, you may want to consult a professional here.

- **Other nonbusiness credits:** You may not be able to take the child tax credit, but if the trust or estate purchases an alternative fuel car (we know, it's a bit unlikely, but you never know), you're in luck. Place the credit for your hybrid automobile here, on line 2b of Schedule G.

- **General business credits:** Enter the total of all the general business credits the trust or estate is entitled to on **Form 3800, General Business Credit**, on line 2c of Schedule G. If you made income distributions during the year, be careful not to include any credits on Form 1041 that are allocable to the income beneficiary.

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- **Credit for prior year minimum tax:** If the trust or estate paid AMT in a prior year, it may be eligible to reclaim some part of that tax on Schedule G, line 2d. Complete **Form 8801, Credit for Prior Year Minimum Tax – Individuals, Estates and Trusts** to see if this return qualifies.

Additional taxes

Even if you manage to reduce the estate, trust, or decedent's income tax liability to zero with a combination of deductions and credits, you may still have taxes to pay. Lines 5 and 6 of Schedule G, Form 1041 are where you find these additional taxes. They're not really income taxes, but they're here on an income tax form for lack of any better place to put them.

Recapture taxes

Sometimes you receive a credit in a prior year, and then, in the current year, you find you're no longer eligible for it. For example, say you purchased a hybrid car last year and then found out this year that you aren't entitled to a credit for that car. Welcome to the world of *recapture taxes,* which recapture tax benefits that the IRS didn't want to let slip away. Complete **Form 4255, Recapture of Investment Credit** or **Form 8611, Recapture of Low-Income Housing Credit**, and then fill in the total on line 5, Schedule G.

Recapture taxes are a fairly technical area. If you suspect you may be subject to them, you may want to check in with a qualified tax advisor for assistance.

Household employee taxes

When a trust pays for household help for a beneficiary, or an estate pays the final wages of the decedent's household help, you may have to complete and file **Schedule H (Form 1040), Household Employment Taxes.** This form is fairly self-explanatory, but you can find a more complete explanation of it in the current version of *Taxes For Dummies* by Tyson, Munro, and Silverman. Put the total household taxes calculated on Form 1041, Schedule G, line 6.

Answering the Questions on the Back of Page 2 (Form 1041)

If you're preparing Form 1041, you're almost done. All that's left is answering some questions at the bottom of page 2.

- Place the total tax-exempt income we talked about in the "Interest" section on the line underneath **Question 1.**

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- When the trust or estate reports earnings of any type that were earned by an individual, check the "Yes" box for **Question 2.**
- **Question 3** wants to know about cash and securities held in foreign accounts. Refer to the list of assets you compiled in Chapter 7, and see if this estate or trust has any foreign accounts. If your trust or estate falls into this category, check the "Yes" box, and enter the name of the foreign country below question 3. Remember, if the trust or estate has no foreign accounts, but owns foreign securities in a U.S. based account, the answer to this question is "no".
- Along the same lines, **Question 4** needs to know about distributions from foreign sources, or whether or not your estate or trust funded a foreign trust. If you answer "yes" and the combined total of all foreign accounts is greater than $10,000, you may have to file **Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts**. You can find this form online at `www.irs.gov/pub/irs-pdf/f90122-1.pdf`.
- **Question 5** asks whether the estate or trust is the holder of a residential mortgage and receives interest payments on that loan. Look back over your list of assets, and make sure there's no promissory note or mortgage still generating payments buried at the bottom of the list.
- If the trust or the estate elects, it may choose to pay the beneficiaries' income earned in the tax year in question as late as 65 days into the next tax year. If you want to make this election, perhaps because you don't know until after December 31 how much income you should pass out to the beneficiaries, check the box next to **Question 6**.
- If you are distributing property in kind (you actually passed the shares of stock out to the beneficiary, instead of selling them and giving him or her a check), you can elect to recognize the gain on that transaction at the trust or estate level. When you include this transaction on Schedule D to report the gain, and pay the tax, the beneficiary then receives the property with the higher, date-of-distribution basis. Check the box next to **Question 7** to make this election (under Code Section 643(e)(3)).
- **Question 8** assumes that most estates run their course within the first two years of the decedent's date of death. If the estate you're administering stretches out longer than that, the IRS wants a brief explanation. Check the box and attach a brief statement.
- **Question 9** is looking for information about skip beneficiaries so that the IRS can attempt to collect even more tax under the generation skipping transfer tax rules. Generally, a *skip beneficiary* is someone who is more than one generation below that of the transferor of the property. So, grandchildren may be skip beneficiaries of their grandparents' estates. In the case of unrelated parties, a skip beneficiary is anyone who is more than $37\frac{1}{2}$ years younger than the transferor.

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Chapter 19

Reporting Tax Info on Schedule K-1

In This Chapter

- Exploring Form 1041, Schedule K-1
- Assigning types of income to Schedule K-1
- Adding addition information to help estate and trust beneficiaries

Looking for hard and fast rules for almost anything is human nature. You stop at red lights and go when they turn green, but yellow lights seem to confuse people. Figuring out who gets to pay the income tax on income earned in a trust or estate is something like a yellow light: Sometimes the trust or estate pays it, and other times the beneficiary does.

In this chapter, we continue where we left off in Chapter 18 regarding **Form 1041, U.S. Income Tax Return for Estates and Trusts**, focusing on **Schedule K-1, Beneficiary's Share of Income, Deductions, Credits, etc.** You see what's included on it and what's not. You also discover the formula necessary to calculate each of the numbers. Finally, you can find out how to report income to a beneficiary when you don't have to file Form 1041.

Understanding the Schedule K-1

A trust or estate that makes distributions to beneficiaries receives an income tax deduction for the exact amount of taxable income that's been distributed (and income always pays out to beneficiaries before principal). This is the so-called *income distribution deduction*, or *IDD*, which is calculated on Form 1041, Schedule B, on page 2 of Form 1041 (see Chapter 18). Although the IDD as determined by Schedule B is a lump-sum calculation, it may comprise many pieces: dividends, interest, capital gains, rents, state income tax refunds. In fact, a trust or estate may be passing out pieces of any number of types of income. And, when trusts and estates pass out income, that income *retains its character*. So dividends earned by a trust and then paid to a beneficiary remain taxable as dividends, capital gains stay capital gains, tax-exempt

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income remains tax-exempt income, and so on. Thus, for example, interest and dividends originally earned by the ABC Trust appear on the beneficiary's Form 1040 on Schedule B, rental income lands on Schedule E, and the foreign income earned and taxes paid by the trust but allocated to the beneficiary land on **Form 1116, Foreign Tax Credit.**

Because the income (and deductions, if any) received by the beneficiaries retains its character, you have to tell the beneficiaries what that character consists of. Do this by completing **Schedule K-1 (Form 1041).** The Schedule K-1 gives the beneficiary the specific allocation between all items of income (and sometimes deductions and credits, too), allowing easy transfer of the information from the K-1 to the beneficiary's Form 1040.

Your job is relatively simple when you're dealing with only one income beneficiary. The total amount of the IDD (Form 1041, Schedule B, line 15) is shown on a single Schedule K-1, with allocations made only between the different types of income. When there are multiple beneficiaries, though, you're required to prepare a separate K-1 for each, with the total IDD divided among the beneficiaries on their K-1s in the same proportion as the distributions were made. So, if the calculated IDD is $10,000, and one beneficiary received half of the total distributed, his or her Schedule K-1 will show a total of $5,000 of income. This section walks you through the Schedule K-1.

General information

You can compare Schedule K-1 (Form 1041) to a giant, combined Form 1099 and Form 1098. And, like both Form 1099 and 1098, it contains much of the same identifying information. Schedule K-1 allows your beneficiary to separate his or her income distribution into all the sorts of income received by the trust or estate; Figure 19-1 shows how much you can cram onto it.

Schedule K-1 (Form 1041) is an attachment to Form 1041, and you must distribute a copy of it to the income beneficiaries no later than the due date for Form 1041, as extended. Don't delay in sending these out. Remember, the beneficiaries can't prepare their 1040s until they receive their K-1s from you.

Part I: Information About the Estate or Trust

In Part I, fill out the tax identification number (the *TIN*), the name of the estate or trust, and the *fiduciary's* (trustee's or executor's) name and address. In Part I, you also have the opportunity to check a box to indicate whether and when you filed **Form 1041-T, Allocation of Estimated Tax Payments to Beneficiaries (Under Code Section 643(g))**.

By checking Part I, Box D of Schedule K-1, you tell the beneficiary that he or she now has credit for additional tax payments, even though the trustee originally paid them on behalf of the trust.

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☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0092

Schedule K-1 (Form 1041) 2007

Department of the Treasury
Internal Revenue Service

For calendar year 2007,
or tax year beginning _____, 2007
and ending _____, 20____

Beneficiary's Share of Income, Deductions, Credits, etc. ▶ See back of form and instructions.

Part I Information About the Estate or Trust

A Estate's or trust's employer identification number

B Estate's or trust's name

C Fiduciary's name, address, city, state, and ZIP code

D ☐ Check if Form 1041-T was filed and enter the date it was filed ____/____/____

E ☐ Check if this is the final Form 1041 for the estate or trust

Part II Information About the Beneficiary

F Beneficiary's identifying number

G Beneficiary's name, address, city, state, and ZIP code

H ☐ Domestic beneficiary ☐ Foreign beneficiary

Part III Beneficiary's Share of Current Year Income, Deductions, Credits, and Other Items

1	Interest income	11	Final year deductions
2a	Ordinary dividends		
2b	Qualified dividends		
3	Net short-term capital gain		
4a	Net long-term capital gain		
4b	28% rate gain	12	Alternative minimum tax adjustment
4c	Unrecaptured section 1250 gain		
5	Other portfolio and nonbusiness income		
6	Ordinary business income		
7	Net rental real estate income	13	Credits and credit recapture
8	Other rental income		
9	Directly apportioned deductions		
		14	Other information
10	Estate tax deduction		

*See attached statement for additional information.

Note: A statement must be attached showing the beneficiary's share of income and directly apportioned deductions from each business, rental real estate, and other rental activity.

For IRS Use Only

For Paperwork Reduction Act Notice, see the Instructions for Form 1041. Cat. No. 11380D **Schedule K-1 (Form 1041) 2007**

Figure 19-1: The K-1 form

What's Code Section 643(g)? It's the section of the Internal Revenue Code that allows you to assign estimated taxes paid by the trust or estate to individual beneficiaries in the final year of the trust or estate. For example, Trust XYZ pays estimated taxes of $1,000 during the year, only to find out

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toward the end of the year that the trust is terminating at the end of the year. Because the trust won't owe any tax in its final year, it doesn't need the estimated tax payments. Rather than have the IRS refund the $1,000 to the now-defunct trust after it files its final 1041, the trustee may elect to assign that estimated tax to the trust's beneficiaries by filing Form 1041-T.

In theory, Form 1041-T is a practical solution to reducing or eliminating underpayment penalties for beneficiaries who had no way to plan for the additional income that's passing to them from the trust. In practice, it's not so straightforward. The IRS doesn't see too many Form 1041-Ts in the course of a year, and isn't quite sure what it's supposed to do with them when it does. It often applies the tax allocations incorrectly, if at all, leaving you to sort out a mess you didn't make. Use your judgment before filing Form 1041-T; if the amounts involved are small, it may just not be worth your while.

Form 1041-T may only be filed in the final year of the trust or estate, is irrevocable, and must be made on or before the 65th day of the year following the end of the trust or estate's tax year (for calendar year filers, that's March 6, or March 5 during leap years). So, if you've made a Code Section 643(g) election and allocated the estimated taxes, you have to check Box E to indicate it's the final year of the trust or estate.

Part II: Information About the Beneficiary

Schedule K-1, Part II is about as simple as it gets. On line F, put in the beneficiary's TIN, and on line G, fill in the beneficiary's name and address.

In Box H, choose between a domestic or foreign beneficiary, whichever applies. If the beneficiary lives in the U.S. (and that includes *resident aliens* who have legally established residence in the U.S.), no further information is necessary. If the beneficiary resides in a foreign country, you may want to consult with a competent tax advisor who can check the foreign tax treaties involved and make sure you're not required to withhold U.S. income taxes on distributions to this beneficiary.

Income items

The best Schedule K-1 is the one that completely breaks down the information into its component parts. Don't assume that just because the trust or estate's tax returns don't require certain information, the beneficiaries don't either. As fiduciary, you want to make their lives as easy as possible.

Among the different types of income that may appear are

- **Interest:** Although the total taxable interest figure, including U.S. Treasury interest, belongs on line 1, show allocations of U.S. Treasury interest (included on line 1, but not taxable in any state) and tax-exempt interest (not included on line 1) separately on line 14.

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- **Dividends:** Place the total of all dividends, from whatever source (including foreign) on line 2a. On line 2b, show the *qualified dividends* — those dividends subject to a lower income tax rate. If the trust or estate has income from foreign sources, include that allocation somewhere on Schedule K-1, either on line 14 or on a supplemental statement attached to the back of the form.
- **Capital gains:** As a general rule, trusts and estates pass out capital gain income to beneficiaries in the final year of the trust or estate only. In the final year, place *short-term* (from the sale of capital assets held one year or less) capital gains or losses on line 3, and long-term capital gains or losses on line 4a. If you sold any artwork or collectible items (your aunt's baseball cards, for example), place that amount on line 4b. Show depreciation added back under Code Section 1250, recaptured when you sell business property you previously depreciated, on line 4c. Section 1250 gains can be tricky; if the Form 1041 you're preparing has this type of income, have a professional help you calculate it.
- **Other portfolio and nonbusiness income:** What ends up on line 5 is typically the portion of a taxable state income tax refund.
- **Ordinary business income:** On line 6, place any business income that the trust or estate may have distributed to the beneficiary.
- **Net rental real estate income:** If the trust or estate owns any rental real estate, or owns interests in rental real estate partnerships, the rental income component of any beneficiary distribution belongs on line 7.

Most of the time determining what types of income the trust or estate's received won't be difficult; however, on some occasions you may not be sure what you're supposed to do with a particular piece of income. Don't hesitate to contact a competent tax professional to advise you.

Deductions and credits

Schedule K-1, in addition to allowing you to split each income distribution into all its component parts, also gives the income beneficiary all the other tax attributes that can pass through the trust or estate to the beneficiary.

Deductions

Except for in the last year of an estate or trust, a Schedule K-1 rarely shows any deductions that the beneficiary can use on his or her tax return. *Deductions* are the payments the trust or estate makes that reduce its taxable income. Still, it can happen, so here are a few you may see:

- **Directly apportioned deductions:** If the trust or estate is passing out *depreciation* (a portion of an asset's acquisition cost that you deduct annually over the period of its useful life), *depletion* (deducting the reduction in value of an asset as that asset is used up) or *amortization*

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(reducing the cost of an intangible asset over its projected life) deductions, you place these numbers on line 9. These calculations can be tricky, and you may want to seek a pro here.

- **Estate tax deduction:** If estate tax has already been paid on a portion of the income earned by the trust or estate, you're entitled to an income tax deduction equal to the estate taxes paid on that income. Place each beneficiary's share of an estate tax deduction on Schedule K-1, line 10.

  For example, say the Whipple Estate, which paid an estate tax at the top tax rate of 45 percent, included a retirement account, on which no income taxes had ever been paid. Every year, it receives $10,000 from that retirement account that is subject to income tax. The estate tax on each distribution is $4,500 ($10,000 × 45 percent). Assuming the eventual recipient of the annual distributions is also taxed in a high bracket, the potential income tax on each distribution could be an additional $3,500, adding to $8,000 total tax, or 80 percent. However, the estate receives an estate tax deduction of $4,500, which may be passed out to an income beneficiary. Even if the beneficiary is in a high bracket, the amount of that distribution subject to income tax reduces to $5,500 ($10,000 distribution – $4,500 estate tax deduction). A 35-percent-bracket taxpayer then only pays $1,925 in income tax on that distribution, or $6,425 in total tax, reducing the tax rate to a nominal 64.25 percent. It's not huge, but it's better than nothing.

- **Final-year deductions:** Often (and despite your best efforts), you wrap up an estate or trust in a flurry of activity accompanied by an avalanche of final fees without much in the way of income to offset them. If you have more fees (legal, accounting, state taxes, or anything else that's a legitimate income tax deduction for the trust or estate) than income in the final year of a trust or estate, you may give them to the beneficiaries on line 11 of Schedule K-1. Short- or long-term capital loss carryovers also belong here, as well as net operating loss carryovers, calculated both for regular tax computations, and for the alternative minimum tax.

Credits

Credits, those dollar-for-dollar offsets against tax that are so valuable to taxpayers, don't appear frequently on Schedule K-1. But that doesn't mean they're not available. The back of Schedule K-1 has a list of credits a trust or estate may pass through to its income beneficiaries — you may marvel at the number, even as you wonder how a trust could ever generate an orphan drug credit. Here are the two most common:

- **Credit for estimated taxes:** Earlier in this chapter, in "Part I: Information About the Estate or Trust," we introduce you to **Form 1041-T**, and the election that a trust or estate may make to pass estimated taxes it's paid out to its income beneficiaries. If you made the election (you know because you already checked Part I, Box D), place this beneficiary's share of estimated taxes on line 13.

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- **Credit for backup withholding:** A beneficiary sometimes gets into trouble with the IRS for failing to pay his or her taxes. If that happens, you'll receive a letter from the IRS instructing you to withhold income taxes on any distributions to that beneficiary. If the trust or estate must withhold on distributions, place the amount that you've withheld and sent to the IRS on line 13.

Alternative minimum Tax information

Pass through all the tax preference items to the income beneficiaries on Schedule K-1, line 12, along with their income distribution. Some of these preference items may carry through from other sources, such as accelerated depreciation on rental property owned by the trust or estate. Others derive solely from the trust or estate itself because of deductions not allowed in the AMT calculation, like state taxes or miscellaneous itemized deductions.

Calculate the most common alternative minimum tax (AMT) adjustment, the *adjustment for minimum tax purposes*, by subtracting the IDD (**Form 1041, Schedule B, line 15**) from the IDD on a minimum tax basis (**Form 1041, Schedule I, Part II, line 44**). With a single income beneficiary, the entire result goes on Schedule K-1, line 12, Code A; allocate the total adjustment between multiple beneficiaries based on the relative size of their distributions.

The days are gone when messing up AMT adjustments didn't matter much because very few individual taxpayers were actually in the AMT; unfortunately, these AMT adjustments only gain importance as more taxpayers are subject to the AMT.

Allocating Types of Income on the K-1

Income earned by a trust or estate that's paid out to a beneficiary in the same year as it's earned must be reported to that beneficiary on Schedule K-1, and that income maintains its character when it's distributed. But how do you know what type of income you're paying out, and do you, as the trustee or executor, have any discretion in what forms of income you distribute?

The simple answer is, you have almost no discretion. Income passes to the beneficiary in the same ratio as it's earned by the trust or estate. So, if a trust earns 40 percent of its income as interest, 30 percent as dividends, and 30 percent as rental, the numbers shown on Schedule K-1 will reflect those percentages: 40 percent interest, 30 percent dividends, and 30 percent rental.

The one exception to this rule concerns capital gains. Except in the last year of the trust or estate, capital gains remain trapped at the trust or estate level, which pays all the income taxes due on them. Of course, there's also an exception to the exception. If you, as the fiduciary, determine to distribute to

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a beneficiary the value of certain property (which must be identified prior to the distribution, and prior to any sale), you may elect to have the beneficiary pay the tax on the capital gain generated by the sale of that property. So if Alex, the trustee of Moe's trust, decides to distribute the value of 50 shares of IBM stock to Sam, the beneficiary, he can sell those identified shares and allocate any capital gain to Sam even though it's not the last year of the trust.

Exceptions aside, you arrive at each individual number by dividing the total for each type of income into the total for all types of income includable on Schedule K-1, and then multiplying the result by the amount of the IDD (**Form 1041, Schedule B, line 15**). Allocations are made across all classes of income, whether taxable (dividends, taxable interest, and rents, for example) or nontaxable (interest from municipal bonds and tax-free mutual funds). Table 19-1 shows a sample, using $10,000 of income, with $7,500 of allowable deductions for professional fees and state income taxes.

Table 19-1 Allocating Classes of Income to Schedule K-1

Form 1041		*Schedule K-1 Allocation*		
Income Amount	Amount	Income Type	Allocation Calculation	K-1 Amount
Interest income	$4,000	Interest	$4,000 ÷ $10,000 × $2,500	$1,000
Dividend income	$3,500	Dividend	$3,500 ÷ $10,000 × $2,500	$875
Rental income	$2,500	Rental	$2,500 ÷ $10,000 × $2,500	$625
Total Income	$10,000			
Less Deductions	($7,500)			
Income Distribution Deduction (IDD)	$2,500	**Total K-1 Income**		$2,500

Income shown on all the K-1s equals the trust or estate's IDD, not the amount of the distributions actually paid. So, even when a beneficiary receives more than $2,500, as in this example, he or she only pays tax on $2,500.

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Preparing Supplements to Schedule K-1

Schedule K-1 allows you to put a vast amount of information on the face of the form, but you often want to give your beneficiaries even more. Don't let the lack of specifically labeled spaces stop you. The more information you manage to cram onto Schedule K-1, the better off the beneficiaries are.

Trustees and executors often pay personal expenses on behalf of a beneficiary (just to be certain those expenses are being paid). If you've paid medical expenses, taxes, or some other form of deductible expenses on a beneficiary's behalf, include that information (listing it by category, not by individual payments) somewhere on either the K-1 itself or on a separate sheet attached to it so the beneficiary will be sure to take the deductions to which he or she is entitled. This section explains other information Schedule K-1 can include.

Showing foreign tax allocations

Foreign stocks and bonds are increasingly common in trust and estate accounts; so, too, are foreign taxes paid on foreign income. Be sure to pass out not only foreign income to beneficiaries, but also the corresponding amount of foreign taxes paid. Show the foreign tax amount on Schedule K-1, line 14, using Code B. Label the foreign income, using Code H on the same line. Alternatively, attach a separate page to the back of the K-1, outlining both the foreign income earned, and foreign taxes paid.

Providing state tax information

Because most states have their own income tax, beneficiaries use their K-1 information to calculate their state income tax. Be sure to provide them with any differences that may impact their state returns, including the amount of U.S. Treasury interest (don't forget U.S. Treasury dividends earned by mutual funds that only invest in U.S. Treasury obligations) and in-state versus out-of-state tax-exempt interest they've received in their distribution.

The beneficiary's residence, not the trust's, is what determines what's in-state against what's out-of-state for beneficiaries. So, an Ohio trust with a Utah resident beneficiary will want to show the Utah tax-exempt interest on that beneficiary's Schedule K-1, not the Ohio.

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Creating nominee Form 1099s

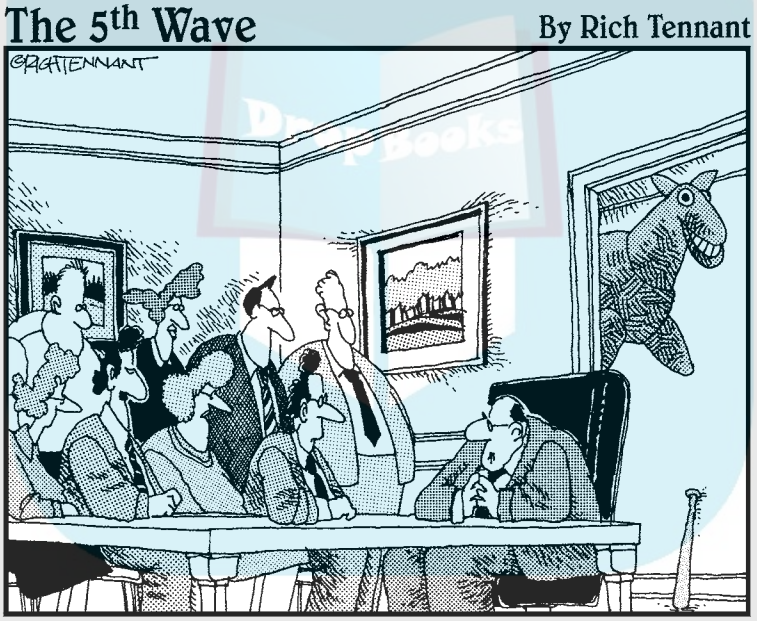
Sometimes, even when the trust or estate doesn't have to file Form 1041, you still receive tax information from other sources. When you won't be preparing a 1041 (perhaps the trust or estate has terminated), there won't be a Schedule K-1 either. Instead, pass along any tax information you receive via a Form 1099 for income earned by property formerly owned by the trust or estate to the property's new owners by issuing them a *nominee Form 1099*.

To prepare this form, copy the 1099 you've received, replacing the payer's name and TIN with the trust or estate's name (adding the words *as nominee* next to the name) and TIN. Place the new owner's name and TIN in the spaces reserved for the recipient. Nominee 1099s can be typed or handwritten on forms available through stationery stores (available in large quantities only), or from the IRS. Be sure to give a copy to the new recipient, and file the top copy (it's preprinted in red) with the IRS together with Form 1096, which is just a transmittal sheet; the filing address appears on Form 1096.

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Part V

The Part of Tens



"As you know, your uncle died intestate, and in this state we have our own way of distributing assets to the heirs. Now, do you all know what a piñata is?

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In this part . . .

We've crammed as much information into these shorter chapters we could. Read on about the mistakes we've made that we hope you avoid — we're more than happy to tell you all about our whoppers if it prevents you from making the same goofs. And we've also given you a list (not complete, but we've hit the high points) of the different types of taxes you may be responsible for paying. Who knew so many people from all levels of government would have their hands held out looking for a share of the pot?

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Chapter 20

Ten Pitfalls for the Unwary

In This Chapter

- Avoiding careless mistakes
- Sidestepping administration dangers
- Using your judgment well

So much of administering a trust or estate is similar to handling your personal finances. However, you can easily forget that you're actually working in a fiduciary capacity, not an individual one, and that there are some major differences. In fact, one of the biggest issues we've run up against when assisting clients, family, and friends in their adventures in administration is in articulating where the differences lie. This chapter covers the lessons we've both discovered regarding what you should and definitely shouldn't do when administering an estate or trust.

Failing to Terminate an Existing Real Estate Purchase and Sale Agreement

As far as costly mistakes go, not ending an existing real estate purchase and sale agreement when the decedent is the seller is huge! Not doing so can substantially increase the taxes you'll owe on the sale, costing the estate, and the eventual heirs, big-time.

Real estate rarely changes hands on the day the buyer and seller agree to the purchase and sale; in fact, it often takes many weeks, if not months, between the handshake and the deed. In that period between the agreement and its final execution, that property's in limbo. You've established a price for it that the courts will almost always accept as its fair market value. But you've also created an expectation of money being received, which it hasn't yet been. So, in essence, because the agreement was reached before the decedent's death, you now have two assets:

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- The property itself (reportable on **Form 706**)
- The cash that's been promised (reportable on **Form 1041**)

You, as executor, are caught in a never-never land; you've lost the all-valuable step-up-in-basis described in Chapter 18, and the estate's also not eligible for the $250,000 per person exclusion of capital gain because the exclusion is per person, not per entity.

When a seller dies in mid-property transfer, canceling the old purchase and sale agreement and rewriting a new one, with the estate as the seller, allows you to take full advantage of the all valuable step-up-in-basis, as well as avoids any income tax on the sale. Remember, the only difference between the old agreement and the new is that the decedent's estate is now the seller, not the decedent.

Taking a Lump Sum Distribution from a Pension Plan or IRA

When you're trying to figure out exactly how much the estate owns, you may be tempted to liquidate everything into cash. Although this thinking may work on some assets, don't do it with any sort of pension plan or IRA. As soon as you cash out that deferred income retirement plan, whether it's a traditional IRA, a 401(k) plan (or its public and nonprofit sector equivalents 403(b) and 457 plans), the estate now owes income taxes on every penny of it that the decedent hadn't already paid tax on. In addition to the income tax bite, you also owe estate taxes on the value of the account as of the date of death (or alternate valuation date, if you make the election; see Chapter 16). Talk about double taxation. One of us had an estate that held a large IRA; between the income and estate taxes paid, the effective tax rate was almost 97 percent.

Far better than taking a lump sum distribution is figuring out which heirs you can roll the account over to. If the decedent has a surviving spouse or children, you have no problem. Using the rollover technique, no one owes any income taxes until the new beneficiaries begin to take distributions; additionally, you can spread those distributions out over a number of years, lessening the tax bracket each distribution is taxed at. Of course, if you have a taxable estate, the value of the account at the date of death is still included for estate tax purposes.

Seek competent tax advice as soon as you discover a large IRA, because there are time limits imposed on retitling it. If the asset in question is a pension, check the plan documents to determine what options are available to the beneficiary.

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Creating a Feeding Frenzy When Splitting Personal Property

Nothing alienates family members like weddings and funerals, and nowhere is this more apparent than when you're dividing up the decedent's personal property among his or her heirs. If the decedent failed to leave instructions regarding who was to receive what property (such instructions are usually kept with the Last Will but are typically not part of it; see Chapter 8), your job as executor is to keep the situation under control.

Keep the following do's and don'ts in mind:

- **Don't allow anyone into the decedent's residence unsupervised.** After carpets, trinkets, and furniture are loaded into the back of someone's van, they're almost impossible to recover.
- **Do change the locks.** Do it whether or not you suspect someone may make a casual visit in the middle of the night. It's just a good idea.

The most equitable way both of us have found to distribute personal property among the heirs is to use multicolored flea market stickers, easily purchased at any discount or stationery store. Give each heir one color and have him or her take turns (oldest to youngest, youngest to oldest, or in an order determined by choosing random numbers) tagging one item at a time. By the time you finish, you'll discover that you're either surrounded by a rainbow of tags or that people mostly just want one or two remembrances; you can sell the rest or give it to charity.

Missing Court Deadlines

Courts hate to be ignored. Make sure you place all the probate court's deadlines on your calendar, circled, underlined, and in neon (if necessary). Even if you haven't been able to complete the task set by the court (preparing the probate inventory, for example), showing up to explain why you're unable to comply usually buys you additional time. Fail to show up, and the courts often demand immediate compliance.

Don't make the mistake of thinking that the probate court isn't a real court or the judge not a real judge just because proceedings have been fairly low-key to this point. These judges have full judicial authority, which includes removing you as executor or trustee, fining you, throwing you in the pokey for contempt of court, or any other such sanctions they deem necessary to make you comply.

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Forgetting Tax Filing Deadlines

You wouldn't fail to file your own tax returns; don't forget to file the trust's or estate's, either. Income tax returns (**Form 1041**) are due three and one half months after the estate or trust's year end, and estate tax returns (**Form 706**) are due nine months after the date of death. Place these dates on your calendar and begin preparation far in advance of the due date so you know about any problems or lack of information far in advance of the filing deadline. Don't forget, extensions are available if you're unable to file returns when due, and you may amend returns that turn out to be incorrect.

What do you do if you know you can't possibly get all the information prior to the return's due date, even if you extend that due date by the maximum six months allowed? If you know it's just a matter of a few months, or a year, you're probably safe in just amending the return after you have all the pertinent data. If what's missing may take longer to acquire (such as litigation begun during the decedent's lifetime, to which you've now become a party), you want to suspend the statute of limitations indefinitely until you resolve whatever's outstanding. To file a protective claim, write "Protective Claim under Reg. Sec. 301.6402-2(2)" across your return in big black letters, and make sure you otherwise pay all taxes due. Be sure to file your return on time (as extended); protective claims work only if every other aspect of the return you've filed has its *t*'s crossed and its *i*'s dotted.

Failing to Communicate with the Heirs and Legatees

Being a trustee or executor isn't cloak-and-dagger stuff, and the heirs, *legatees* (individuals left specific property under the will), and beneficiaries on whose behalf you're working aren't enemy agents. Keep them in the loop as much as you can. By letting them know on a regular basis where you are in the process and when they can realistically expect a payment from the estate, you're stopping most, if not all, of their complaints before they have a chance to even think of them.

You can't please all the heirs all the time, especially those who are upset that they weren't named executor. Be especially responsive to their concerns: Because the estate process is under the probate court's supervision, an heir who complains to the judge only creates more work for you because you now have to respond to the judge's questions as well.

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Exercising Poor Fiduciary Judgment

The days are long gone when executors and trustees were only rarely called on the carpet for exercising poor fiduciary judgment. As more people have started investing personally, whether through their retirement accounts or through Internet brokerages, they've become much more sophisticated and knowledgeable about the entire investment process. And they've also become much more likely to comment unfavorably on your handling of the trust or estate's assets. As the executor and trustee, you must act prudently and deliberately, seeking advice when you need it, investing the assets wisely, and paying the bills and the beneficiaries when they're due to be paid.

Remember that the decedent or the donor chose you to look after his or her property because of your good judgment, so don't hesitate to employ a professional to help you in choosing investments for the estate or trust. If you do turn to professional help, make sure you check references and determine how much experience that person has in the investment of trust and estate assets (which should be fairly conservatively, but broadly, invested across all industries). If a trust is ongoing, for example, a general rule is that the trust should own pieces of between 140 and 175 different companies, in addition to whatever bonds or other savings accounts it owns. If yours is a smaller trust, and buying stock in all these companies would result in purchases of only a few shares, you can easily meet this standard by investing in a few well-chosen mutual funds.

Underestimating the Devotion Required

People rarely understand the magnitude of the task in front of them when someone asks them to act as executor or trustee. Even if they did, the date when the job ceases to be theoretical and the action really begins is often so far in the future that they can't even imagine such a time.

If you've accepted an appointment as an executor, administrator, or trustee, you've agreed to act reasonably and responsibly. This job isn't a small favor you can discharge in an hour or two, or even in a day or two. It's a major commitment on your part to carry out the stated wishes of the testator or grantor. Treat this commitment with all the care that you would lavish on a beloved relative or friend.

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Taking Nonsanctioned Shortcuts

As you wend your way through the seemingly endless administration of an estate or trust, you may be tempted to look for ways to reduce your workload. After all, most people take shortcuts on their personal finances, and everything usually works out fine. Resist the temptation to find an easier route through the administration process.

No one will ever disagree that many of the steps you're supposed to take seem pointless, but you must take them nonetheless. So if you're supposed to publish a notice in a certain paper, make sure to do so. If you should have a piece of property appraised, don't assign it a value and move on; hire an appropriate appraiser, pay the fee, and get the appraisal in writing. Taking shortcuts through an estate or trust may save you some time upfront, but the cleanup costs on the other end, when the IRS wants to see the proof that you've valued something correctly or your accounts don't balance, can be huge.

Whether you're administering an estate or trust under the eagle-eye supervision of the probate court or you're merely answerable to the beneficiaries, you're responsible. Failure to follow through on those responsibilities may open you up to removal as fiduciary as well as potential lawsuits from any person having an interest.

Paying from the Wrong Pocket

Money may always seem like money to you, but within a trust, it belongs to either principal or income. And, although making a distinction between the two may seem silly when paying trust bills, you really must. Because different people may be entitled to receive money and property from either income or principal, making payments (whether expenses or distributions) from the correct side of the account is crucial. More than one trustee has been sued because they paid all trustee fees from principal (or income), for example. Remember, when you make all payments from one side, you favor the eventual owners of the property from the other side (because their share will grow faster). To avoid any hint of favoritism, allocate fees and expenses against the type of income that generated that cost. When you're not sure (like with your trustee's fee), create an equitable formula so that a certain portion of your fee is always paid from principal, and the rest from income.

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Tax Returns You May Have to Prepare

You may have to prepare a seemingly endless array of tax returns when you're administering an estate or trust. Check with your accountant or attorney if you have any questions. Here are some of the most popular.

Federal Tax Form Number and Name	*When It's Required*	*When It's Due*
Form 1040 U.S. Individual Income Tax Return	When the decedent had income prior to death that hasn't been reported.	April 15 following the year of death; auto-matic 6-month extension of time to file provided Form 4868 is filed on or before April 15. Form 4868 doesn't need to be filed if no tax is due; the extension is automatic.
Form 1041 U.S. Income Tax Return for Estates and Trusts	When the estate or trust receives income earned.	3½ months after the year-end of the estate or trust; most trusts are required to use a December 31 year end, but estates may elect a fiscal year, provided the first fiscal year ends no later than 11 full months after the date of death.
Form 706 United States Estate (and Generation-Skipping Transfer) Tax Return	For estates with assets more than a certain amount. Even though not every estate with assets over that amount will have an estate tax, those estates are still required to file.	9 months after date of death; due date may be extended by 6 additional months for cause.
Form 709 United States Gift (and Generation Skipping Transfer) Tax Return	Generally, if the decedent gave gifts to someone (other than his or her spouse) totaling more than $12,000 in a calendar year, or if the decedent was splitting gifts with a surviving spouse who made the gifts, and the gifts haven't yet been reported.	April 15 of the year following the year the gift was made.
Form 1310 Statement of Person Claiming Refund Due a Deceased Person	If a tax refund is due a decedent on his or her Form 1040 (whether final or any prior year), but he or she has no surviving spouse or court-appointed representative, the person requesting the refund must complete and file Form 1310.	File together with the related tax return. If claiming a refund for a prior year for which a tax return has already been filed, send as soon as possible to the IRS Service Center where the original return was filed.
Form SS-4 Application for Employer Identification Number	For any trust or estate that will maintain bank or brokerage accounts, or to whom anyone who makes a payment may be required to issue either a Form 1099 or a Form W-2.	Immediate prior to opening any accounts for estate or trust. You can apply online at `www.irs.gov`.
Form 1099-MISC	To report payments in any amount to attorneys, or of $600 or more to accountants, trustees, or any non-corporate entity to whom the estate or trust paid compensation.	Send copy to recipient no later than January 31 of the year following the tax year involved. Copy should be filed with the IRS by February 28 (if filing on paper, and accompanied by Form 1096), or by March 31 if filing electronically.

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What to Do When Someone Dies

If you're an executor, personal representative, or administrator of an estate, you need to start the process somewhere. The following are tasks you want to take care of in the first days and weeks after the decedent's death.

- Determine the decedent's wishes regarding arrangements such as funeral and burial.
- Obtain copies of the death certificate.
- Ascertain whether the decedent had a last will and other estate planning documents and then try to find them.
- Apply for a federal Taxpayer Identification Number for the estate, using form SS-4. This is like a Social Security Number for the estate.
- Figure out the decedent's *domicile* (where he or she "lived" for probate and tax purposes) and where real property (real estate) is located, because the executor may have to probate the estate in multiple jurisdictions.
- Determine whether you need professional advisors such as an attorney, CPA, or enrolled agent.
- If the decedent has no surviving spouse
  - Change the locks on the decedent's residence immediately.
  - Locate and take possession of decedent's checkbook and credit cards and notify banks and credit card companies.
  - Notify the decedent's homeowner's insurance company and automobile insurance company. Add executor, when appointed, as insured and determine if coverage, particularly on items of unusual value, is adequate.
- Cancel pending contracts (such as purchase and sale agreements on real estate) and rewrite as executor.
- Marshall and safeguard decedent's assets:
  - Locate safe-deposit box and inventory its contents.
  - Collect information regarding type, value, and manner of holding for all the decedent's assets.
- Determine *heirs at law* (those who would inherit if the decedent was will-less) and beneficiaries (those who inherit in the presence of a will) of the decedent's estate.
- Decide if probate of the decedent's will (or administration of the decedent's estate) is necessary and file the decedent's last will with the probate court.
- If probate is necessary
  - Figure out whether *ancillary*, or supplemental, probate is also necessary (for real property in another state).
  - Decide whether temporary administration of the estate is necessary for assets that must be dealt with immediately.

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Chapter 21

Ten Types of Taxes You May Have to Pay

In This Chapter

- Making sense of the transfer-tax trio
- Figuring out the difference between taxes on income and taxes on owned items

We'd love to be able to be able to tell you that negotiating your way through the tax implications of estates and trusts is an easy matter. Unfortunately, it can get pretty complicated because one event can often lead to multiple taxes being owed. Don't ask us why. We don't make the rules, but we're stuck with 'em the same as you.

In this chapter, we give you the top-ten list, in no particular order, of the taxes you may come across in the process of administering an estate or trust. Chances are good you won't be responsible for paying all of them, but the odds are also good that you won't avoid paying taxes altogether.



With the exception of federal income taxes and federal and state estate, gift, and inheritance taxes, all taxes you pay on behalf of the trust or estate are deductible on that entity's income tax returns. Of course, you actually have to have paid the taxes in order to deduct. If the check is written but still sitting in the envelope waiting to be mailed on the last business day of any tax year, you can't use that deduction until the next year.

Federal Estate Tax

The federal estate tax is the granddaddy of the transfer-tax system. Estates valued in excess of $2.5 million for people who died in 2008, $3.5 million in 2009, and currently $1 million in 2011 and beyond must fill out **Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return** and pay whatever tax is due. If you're lucky enough to be administering a qualifying estate, you're entitled to all the fun of preparing Form 706. Don't worry, we explain how to do just that in Chapter 17.

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You may have noticed that we left the year 2010 out of the preceding paragraph. That's because in 2010, the federal estate tax will be repealed for one year only. In 2011, the old, pre-2002 rules (before Congress started tinkering with the estate tax) will return, dropping the amount that may pass tax free back to $1 million. What will actually happen in 2011 and beyond has been the subject of much debate in Congress, but nothing is likely to change the 2011 scenario in the near future.

State Inheritance or Estate Tax

Just as many states impose an income tax (like the federal income tax), many also impose estate or inheritance taxes. Most states used to calculate these taxes based on a credit on the federal **Form 706.** In other words, if the federal government was going to allow a credit for state estate or inheritance taxes, most states said, hey, just give us that money instead**.** You didn't end up paying any less tax, but the total tax you paid was split between the IRS and the state. However, as the credit for state estate taxes paid was whittled away on Form 706, most states stepped up to the plate and pegged their portion of the tax to what it would've been based on a prior year's calculation.

For example, Vermont calculates its estate tax based on federal estate tax rules in effect on January 1, 2001, whereas Kansas computes its tax by using federal laws that went into effect in 1997. See Appendix B for a complete list of what each state is doing with regard to inheritance or estate tax as of the date of publication. ***Remember:*** You need to check with your state's tax department to get the rules in effect at the time of your *decedent's* (deceased person's) death. And, if you're faced with an estate that owns property in more than one state, you may want to consult a competent tax professional because the estate may owe estate or inheritances taxes in each of those states.

Estate and Trust Income Taxes (Federal and State)

Like individuals, partnerships, and corporations, estates and trusts have the ability to earn income — which means that income is subject to income tax. If you have more than $600 of income for an estate, $300 for a simple trust (all income must be distributed currently), or $100 for a complex trust (every other type of trust), you need to complete and file **Form 1041, U.S. Income Tax Return for Estates and Trusts.**

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If the trust or estate has a tax home in a state with a state income tax, guess what? You get to file a state income tax return there. How do you know where the estate or trust's tax home is? In the case of an estate, the tax home is the state where the decedent was domiciled at the time of his or her death. For a trust, the rules are slightly more complex. Basically, if the *grantor* (person who created the trust) resided in the same state as at least one of the trustees when he or she either set up the trust or died, the trust is deemed a resident of that state. If there's no match between the grantor's and the trustee's domiciles, then the trust is considered without a *situs,* or location, and no state income tax return is required.

State Intangibles Taxes

Some states have intangibles taxes rather than income taxes. *Intangibles* are those items of property that you can't readily hold in your hand, such as stocks and bonds. With an intangibles tax, the market value of these items is tallied up once each year. Then the tax is calculated using a percentage of the market value. We tell you which states have intangibles taxes, and which don't, in Appendix B.

Real Estate Taxes

If the trust or estate you're administering owns real estate, you must pay the real estate taxes every year, either by paying the city or town directly or by making sure that you're paying into an escrow account maintained by the bank that holds the mortgage on the property, if any. Real estate taxes, also called *property taxes,* are calculated based on a property's assessed value. This value is subject to reassessment at various times, including whenever the property changes hands or when the city or town in which the property is located decides to update all of its property assessments.



Don't accept your new assessment if you feel it's unjust. You're entitled to question it. If the new assessed value seems unfair, submit your grievance, in writing and within a very short period after you're notified of the change, to either the city assessor or town clerk. (Who you send your grievance to depends on the rules of your city or town, which should be clearly spelled out and sent with the new assessment.) One of us recently underwent a citywide reassessment that was, at a later date, completely thrown out as unusable because the valuations for similar properties varied so widely and the assessor couldn't provide adequate documentation for her valuations. But the overall assessment was only questioned *after* the flood of grievances was received at city hall. In this case, it was possible to fight city hall and win.

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Excise Taxes (Personal Property)

Planes, boats, automobiles, and any other objects that move are often assessed an annual *excise tax*. If the trust or estate you're administering owns property subject to excise taxes, you need to be certain they're paid. Unpaid excise tax bills may lead to tickets and, in extreme cases, seizure by the taxing authority. Trust us, leaving your office for lunch to find a boot nailed to the axel of the estate's car is pretty awful.



Excise taxes, although owed to the state, are usually paid to the city or town where the property is garaged.

Local Income Taxes

In the grand scheme of things, few cities, towns, or counties impose an income tax, but enough do so as to affect lots of people. If your estate or trust is resident in one of these locales, you must calculate not only the state income tax but also the local one. Fortunately, these local calculations are usually done right on the state income tax return (we know you're delighted you probably don't have to fill out yet another tax return), and they piggy-back right onto the state calculation. Consequently, figuring out how much you owe isn't tough, provided you've already successfully tackled the state income tax calculation.

Decedent's Final State and Federal Income Taxes

Just because someone has died doesn't mean he or she gets out of filing income tax returns for the year of his or her death. Well, the decedent doesn't have to, but you do. So, in addition to preparing the returns for the estate and/or trust, you also have to prepare **Form 1040, U.S. Individual Income Tax Return** for the decedent. When preparing the form, make sure you write "Deceased" and the date of death next to the decedent's name. You may also want to write "Deceased" and the date of death across the top of the return in bold letters or red pen. No one ever accused the IRS of reading everything that's sent to it — sometimes you need to surround important information in neon lights to make sure you're getting your point across.



Surviving spouses need not file a separate return in the year their husbands or wives died. Instead, a surviving spouse may file one last joint return. Both personal exemptions are available, as is the full joint standard deduction, and

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the slightly lower *married filing joint* tax rates, even if the deceased spouse died early in the year. Check out Chapter 18 for more information on filing the decedent's final Form 1040.

Gift Tax

Large transfers made during lifetime (what a way to say "a gift") may be subject to the *gift tax,* one of the group of transfer taxes that also features the estate tax and the generation-skipping transfer tax. If transfers are made into a trust during the grantor's lifetime, those transfers may be subject to the gift tax. Chapter 11 tells you what you need to know about the gift tax and filing **Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return.**

Generation-Skipping Transfer Tax

The last, and least understood, of the transfer-tax trio, the *generation-skipping transfer tax* (GST) is assessed when property moves from one generation to another, skipping intermediate generations along the way. So property that goes from a grandparent (or grandparent's estate) to a grandchild (or in trust for the benefit of a grandchild) is subject to this tax, provided that the grandchild's parent is still alive at the time the transfer is made. Property transferred between unrelated people who are more than 37½ years apart in age is also subject to this tax.



Unlike the estate tax, which is only assessed after the decedent's death, and the gift tax, which only comes into play while the donor is still alive, the generation-skipping transfer tax may be assessed either during the donor's lifetime or after his or her death. This tax is assessed in addition to, not instead of, the estate or gift tax; it generally equals the amount of transfer tax that would've been generated had the property made all the generational steps, not just the skipping ones.

Depending on whether this tax is being assessed for a gift made during the donor's lifetime or for a bequest or devise made after death, the GST is calculated either on **Form 709, U.S. Gift (and Generation-Skipping Transfer) Tax Return** or **Form 706, U.S. Estate (and Generation-Skipping Transfer) Tax Return.**

If you suspect that you may be in the middle of a situation that involves a skip generation, look at Chapter 3 to find out what you need to know.

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Glossary

administrator: A person appointed by the probate court to administer the estate of a decedent when the decedent left no valid will.

amortization: Reducing the cost of an intangible asset over its projected life.

ancillary administration: Separate probate of real property in the jurisdiction in which it's located.

annual account: All of a trust or estate's activity for a 12-month period.

annuity: Income paid in a series of payments.

applicable federal rate (AFR): The minimum interest rate you must charge on a loan in order for it to be considered fair market rate.

assets: Items of value owned by any entity, whether an individual, corporation, partnership, trust, or estate.

basis: The acquisition cost of any asset.

beneficiary: The person or entity receiving a benefit from an estate or trust.

beneficial interest: The right to receive some benefit, profit, or distribution from a trust.

bequest: A legacy or gift of personal property by will.

bill: Any short-term loan packaged as an investment product and issued with a maturity of one year or less.

by right of representation: See ***per stirpes.***

bond (fixed income securities): Any long-term loan packaged as an investment product and issued with a maturity of more than ten years.

Charitable Lead Annuity Trust (CLAT): A trust that makes a fixed number of annual payments, calculated as a percentage of the asset value as of the date of the grantor's gift into the trust, to charity. At the end of the lead period, the remaining assets are distributed to non-charitable remaindermen.

Charitable Lead Unitrust (CLUT): A trust that makes a fixed number of annual payments to charity, calculated on a percentage of the assets valued on the second business day of each year. At the end of the lead period, the remaining assets are distributed to non-charitable remaindermen.

Charitable Remainder Annuity Trust (CRAT): A trust where the grantor receives fixed payments for life, calculated as a percentage of the asset value as of the date of grantor's gift into the trust. At grantor's death, remaining assets are distributed to charity.

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Charitable Remainder Unitrust (CRUT): A trust where the grantor receives payments for life, calculated annually based on a percentage of assets valued, usually on the second business day of each year. At grantor's death, assets remaining are distributed to charity.

children's trusts: Trusts created to benefit grantor's children. Often used to provide grantor with the ability to control children's inheritances even after death. Sometimes distributable as child reaches a certain age.

churn: To buy and sell securities frequently with the sole intention of earning more commissions.

codicil: A change to a will, executed with all the formalities of a will. Usually located with the decedent's last will.

community property: Property acquired by either spouse during the course of a marriage in a state whose laws recognize community property.

common law: Law deriving from court decisions and ancient usages and customs, as opposed to statutory law, created by legislatures.

conservator: Similar to a guardian, but with less-restrictive rules.

consideration: A benefit that must be bargained for between parties as an essential reason for the parties to enter into a contract.

corpus: Principal or body of the trust.

Crummey trust: A trust structured to create a brief window of time for a present interest of gifts to the trust, so that no gift tax will be payable on annual exclusion gifts to the trust.

curtesy: The right of a widower, under common law, to a life estate in the decedent's real estate. Abolished in many states.

CUSIP number: The nine-digit identifier for a marketable security, issued by the Committee on Uniform Security Identification Procedures.

death tax: Common nickname for a tax on the value of all of the decedent's property at date of death. More properly referred to as an **estate tax.**

decedent's estate: The property owned by the decedent on his or her date of death. Has different meanings for both probate and estate tax purposes.

declaration date: The date a corporation declares (announces) it will be paying a dividend.

delivery instructions: The specific routing and account numbers necessary to send cash and/or securities from one bank or brokerage to another.

depletion: A reduction in value of an asset as that asset is used up.

depreciation: Recovering an asset's value ratably over its useful life.

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devise: Term describing how real property is left by will.

direct skip: A transfer of property from grandparent to grandchild, bypassing the grandparent's surviving child.

disclaim: To refuse to accept a bequest or devise before it's received.

domicile: Legal home or residence.

donee: Person receiving a gift of property.

donor: Person making a gift of property.

dower: A provision of state law in some states that gives a widow (and sometimes a widower) a life estate in a portion of the real estate owned by the decedent, based in common law.

dynasty trust: A trust lasting for several generations that provides protection from both the generation-skipping transfer tax and from creditors.

electing small business trust (ESBT): A trust that may make an election in order to own stock in a Subchapter S corporation.

enrolled agents: Tax professionals licensed by U.S. Department of the Treasury.

equities: See ***stocks.***

executor: The person named in the will to carry out the decedent's wishes.

executor's bond: A written promise to faithfully carry out the executor's duties.

face amount: Amount of money a bond issuer pays a lender at maturity.

family pot trusts: Trusts where the trustee has discretion to distribute income, and (in accordance with the terms of the trust) principal to any or all of the named beneficiaries — typically the decedent's spouse and descendants.

family trustee: A trusted member of a grantor's family or a family friend.

fee simple: Absolute ownership of real property, but limited by the four basic government powers of taxation, eminent domain, police power, and escheat. May also be limited by certain obstructions or a condition in the deed.

fiduciaries: People to whom property is entrusted by one person for another's benefit. Includes *executors, administrators, personal representatives, trustees, guardians,* and *conservators.*

fiscal year-end: Ending a tax year at the end of any month except December.

fixed income securities: See ***bill; bond; notes.***

funded trusts: Trusts that hold assets.

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general power of appointment: The power of the trust beneficiary to appoint all or any of the trust property to anyone he or she chooses, including himself or herself, or his or her estate, at any time during his or her lifetime, or upon his or her death.

grantor: The person who creates the trust. Also referred to as the *settlor*.

grantor retained annuity trust (GRAT): A trust into which the grantor transfers property and receives a scheduled and fixed payment from it based on a percentage of the initial value of the transfer for a period of years.

grantor retained income trust (GRIT): A trust into which the grantor transfers assets while retaining income earned by those assets for a period of years. At the end of the period, the assets either distribute to the beneficiaries or remain in trust for the beneficiaries' benefit.

grantor retained unitrust (GRUT): A trust into which the grantor transfers assets while retaining the right to receive an annual payment from the trust for a period of years. Payment calculated is a percentage of the annual asset valuation, usually done on the second business day of each calendar year.

gross estate: The total value of all the decedent owned at date of death.

guardian: A person appointed by the probate court to take care of another and his or her property when the property owner is deemed incapable of taking care of his or her own affairs because of age (in the case of a minor) or other reasons such as mental illness, mental retardation, physical incapacity, or illness.

guardian ad litem: A guardian appointed by the probate court for a particular matter in order to protect the beneficiary's interest.

heirs-at-law: Persons who inherit a decedent's estate under state statutes of descent and distribution if the decedent died intestate.

high yield bonds: See ***junk bonds***.

incidents of ownership: Having the right to name or change the beneficiary of a life insurance policy, to assign the policy to another or revoke the assignment, to surrender or cancel the policy, and to pledge the policy as collateral for a loan or to obtain a loan against the surrender value.

income: Everything earned by the principal of the trust other than capital gains and extraordinary dividends.

independent trustees: Fiduciaries who have no interest in the trust grantor, the trust beneficiaries, or the trust remainderman.

inheritance tax: Tax on the amount inherited by a particular beneficiary rather than the estate as a whole.

inventory: A list showing a trust or estate's beginning assets, including the starting basis for each asset.

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intangibles: Assets that you can't readily hold in your hand, such as stocks and bonds.

intangibles tax: A tax on certain intangible assets.

inter vivos trust: A trust created by trust instrument during a grantor's lifetime.

intestate: When a decedent dies and leaves no valid will.

irrevocable trust: A trust where the governing instrument may not be revoked or changed, even by the grantor.

issue: All persons who have descended lineally from a common ancestor.

joint tenancy with right of survivorship: Title passes automatically to surviving joint tenant(s) on the death of one.

junk bonds: Corporate or government bonds paying a high rate of interest, where the debtor may be judged to be in danger of defaulting on the debt.

legacy: A bequest or gift of personal property by will.

life estate: Right to use property and receive any income it earns for the remainder of the tenant's life.

limited power of appointment: The right of a trust beneficiary to designate, from a group of specified appointees (usually the grantor's children and grandchildren, or charities), who may receive trust assets either at any time or after the death or other termination of the beneficiary's interest.

living trusts: Trusts created (and sometimes funded) during the grantor's life.

load: Sales charges paid by investors to purchase mutual fund shares.

marital trust: A trust for the benefit of the surviving spouse typically funded by a formula that takes full advantage of the marital deduction to avoid paying any federal estate tax at the first spouse's death.

mean: Average. Also your older brother when he held you down and tickled you until you almost wet your pants.

municipal bonds: Bonds issued by states, cities, and towns. The interest earned is typically tax exempt.

net income: All income (excluding capital gains and principal dividends) minus expenses (such as the trustee's and tax preparer's fees) paid from income.

nominee trust: A trust in name only, designed to own real estate and allow the owner of the beneficial interest in the trust to keep his or her name off the property deed, out of the local Registry of Deeds, and out of public view.

notes: Any loan packaged as an investment product with a maturity

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of more than one but not more than ten years.

original will: The only signed copy of a will at any given time.

paid-up policy: A life insurance policy on which all the premiums have been paid. The policy remains in force until the insured's death.

payable on death (POD) account: See ***Totten Trust.***

payment date: Date a stock dividend is paid to shareholders of record.

per capita: Divided equally among the total number of persons.

per stirpes: When a named beneficiary predeceases the testator, that beneficiary's share divides equally among his/her children, so that the issue of a deceased child to receive equally divided portions of that child's share and so on. Also known as *by right of representation*.

personal property: Any tangible property that can be physically moved.

personal representative: A general term for executor and administrator.

power of appointment: The power to decide who will be the ultimate owner, or have the enjoyment of, any or all of the property of a trust (and when).

power to revoke: The ability to alter, amend, or terminate a legal document or the enjoyment of property transferred.

prefunded: The issuing authority has the option of paying off the loan early.

present interest: Having all right, title, and interest in property when given.

pretermitted heir: A child, whether born before or after the testator's death, or descendant of a deceased child of the testator who is unintentionally omitted from the will.

principal: The assets owned by a trust. See also ***corpus***.

probate: The process by which a decedent's will is proved to be valid or invalid and the estate is administered and settled after death.

probate estate: Property subject to court supervision; assets held in the decedent's name alone at the date of death or payable to the estate, or held jointly only for the decedent's convenience.

property subject to claims: Assets available to pay the decedent's creditors.

prospectus: A brochure created by every mutual fund that details the fund's governing rules and lists a sample investment portfolio for the fund.

qualified heirs: Certain close family members, defined by state statute.

qualified personal residence trust (QPRT): A trust into which the grantor transfers a home while

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retaining the right to live there, rent free, for a period of years.

qualified Subchapter S trust (QSST): A trust that is allowed to own stock in Subchapter S corporations.

qualified terminable interest trust (QTIP): A trust that typically pays all net income (but only a limited amount of principal) to the surviving spouse, with no power of appointment.

quasi-community property: Property acquired by either spouse in a non-community property state that would have been community property had the couple resided in a community-property state.

real property: Land and land improvements, including all buildings.

reciprocal will: Will written by one spouse, giving all (less bequests of specific personal property) to the other, mirroring the other spouse's will.

record date: Day on which stockholders must own shares to receive a dividend.

residuary devisee: A person or entity named to receive all the real property not specifically devised.

residuary legatee: A person or entity named to receive all the personal property not specifically bequeathed.

return of capital: When payment is received that reduces the asset's acquisition costs because some part of what was originally owned no longer exists.

reversionary interest: The right to the return of property that the transferor has temporarily transferred to or for the benefit of another person.

revocable trust: A trust that can be amended, revoked, or terminated at any time prior to the grantor's death by the grantor. Also known as a *revocable living trust.*

separate property: Assets owned prior to marriage, inherited or received as a gift during marriage, or earned after separation in a community-property state.

settlor: The trust's creator. See also ***grantor***.

short year: A tax year consisting of fewer than 12 months.

signature guarantee: A stamp or seal from a commercial bank or stock brokerage, validating a signature.

single premium life insurance: A policy purchased with one premium.

situs: Where the property is treated as being located for legal purposes.

small business stock: Stock from a closely held corporation.

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socially responsible investing: An investment strategy that integrates social or environmental criteria into financial analysis.

special (extraordinary) dividends: The corporation has issued a larger than ordinary slice of the corporate profits.

special power of appointment: Any power that can't be exercised in the manner described for a general power of appointment.

specific devisee: A person or entity named to receive specific real property under a will.

specific legatee: A person or entity named to receive designated personal property under a will.

spendthrift trust: A trust that gives absolute control of the income and principal to the trustee to prevent the beneficiary from squandering money.

split interest charitable trust: A trust where the grantor retains either a lead or remainder interest in the trust property, with the opposite interest (lead or remainder) going to charity.

statutory share: The share an heir is entitled to under state law if the decedent left no valid will.

stocks (equities): Ownership interests in corporations.

street name: Ownership records of marketable securities maintained by brokerage firms rather than by individual corporations. Owners receive regular statements of their holdings rather than individual certificates.

Subchapter S corporation: A small corporation that pays no corporate income tax but rather distributes all items of income and deduction directly to the shareholders, who then must pay applicable income taxes.

taking against the will: Surviving spouse's election to receive share of estate as determined by state spousal share laws rather than by decedent's last will.

tenancy by the entirety: Title passes automatically to the surviving joint tenant, who can only be a surviving spouse.

tenant in common: Each tenant holds property with other tenants in common but none have rights of survivorship in each others' shares.

term insurance: Insurance that provides coverage for a set period and builds no cash value. The premium generally increases with age.

testamentary trust: A trust that is contained in the decedent's will.

testate: When a decedent dies leaving a valid last will.

testator: A person who has a will.

Totten trust: The grantor opens a bank or brokerage account, using specific language. At death, property transfers directly to the named successor.

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trust: A legal entity that holds assets for the benefit of a person or entity.

trust accounting income: The net income less expenses paid from income.

trust instrument: The legal document (other than the last will) created by the grantor during life that contains all the provisions of the trust.

trustee: A person, bank, or trust company that holds and administers the assets of a trust for the benefit of another.

U.S. Treasury obligations: Loans issued by the U.S. Treasury in the form of bills, notes, or bonds. Interest is taxed federally but exempt in every state.

unlimited marital trust: A trust set up for the benefit of the surviving spouse, who receives the net income plus whatever principal he or she desires, and over which he or she may have a general power of appointment.

usufruct: The temporary right to the use and enjoyment of another's property.

variable universal life insurance: Similar to whole life insurance except you may invest cash value in the policy in mutual funds offered by the insurance company. The rate of return depends on success of those investments.

whole life insurance: A life insurance policy where the portion of premiums not used to purchase term life coverage is invested by the insurance company, providing the policy owner with a stated rate of return.

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Appendix B

State-by-State Summary of Probate, Estate, or Inheritance Tax, and Rules of Intestacy

The laws of *Intestacy* (how a decedent's estate is distributed when no valid last will exists) as well as the wording in state statues vary by state. We summarize a portion of these laws to give you a taste of the similarities and differences between states. However, because these laws can be quite complex, consult with a competent attorney who's an expert in estate law before you make any intestate distributions. Keep in mind that although these are the laws in effect as this book is published, they're subject to change. To look farther down the line of descent and distribution than what we provide here, refer to your individual state statute regarding Intestacy.

Alabama

Rules of Intestacy

Surviving spouse:

- **No surviving issue or parent:** 100 percent of estate.
- **No surviving issue but surviving parents:** First $100,000 plus ½ of the remaining estate balance.
- **With issue that are all also the issue of the surviving spouse:** First $50,000 plus ½ of the remaining estate balance with remainder distributed equally among the issue.
- **With issue that aren't all issue of the surviving spouse:** ½ of the estate with the remaining ½ distributed equally among the issue.

No surviving spouse (or portion not distributed to surviving spouse):

- **With issue:** Estate distributes equally among the same degree of kinship. With unequal degrees of kinship, those of more remote degree take by right of representation.
- **No issue but surviving parents:** Parents share equally.

For further levels of descent and distribution, see state Intestacy statute.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact the Alabama Department of Revenue, 50 North Ripley St., Montgomery, AL 36132; Phone: 334-242-1034; Web site: `www.ador.state.al.us` for further information.

Alaska

Rules of Intestacy

Surviving spouse:

- **No surviving descendant or parent of the decedent, or all descendants of decedent are also descendants of surviving spouse and no other**

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descendants of surviving spouse survive decedent: All of estate.

- **No descendants but a surviving parent:** First $200,000 plus ¾ of the remaining estate with remainder distributed equally among parents.
- **All of the decedent's surviving descendants are also descendants of the surviving spouse, and the surviving spouse has one or more surviving descendants who are not descendants of the decedent:** First $150,000 plus ½ of the remaining estate with the remainder of the estate to decedent's descendants by representation.
- **If one or more of the decedent's surviving descendants are not descendants of the surviving spouse:** First $100,000 plus ½ of the remaining estate with the remainder of the estate to decedent's descendants by right of representation.

No surviving spouse (or portion not distributed to surviving spouse): Same as Alabama, but substitute "descendant" for "issue" wherever it appears in this regard.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact the Alaska Tax Division, 550 West Seventh Avenue Suite 500, Anchorage, AK 99501-3555; Phone: 907-269-6620; Web site: `www.revenue.state.ak.us` for further information.

Arizona

Rules of Intestacy

Note: The intestate estate consists of 100 percent of separate property and 50 percent of community property.

Surviving spouse:

- **No surviving issue or all surviving issue are also issue of surviving spouse:** 100 percent of estate.
- **Surviving issue and one or more aren't issue of surviving spouse:** 50 percent of separate property with no interest in decedent's 50 percent of community property.

No surviving spouse (or portion not distributed to surviving spouse): Same as Alabama, but substitute "descendant" for "issue" wherever it appears in this regard.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact the Estate Tax Office, Arizona Department of Revenue, 1600 West Monroe, Phoenix, AZ 85007-2650; Phone: 602-255-3381; Web site: `www.revenue.state.az.us` for further information.

Arkansas

Rules of Intestacy

Estate distributes first to the decedent's children and their descendants.

Surviving spouse:

- **No descendants and married more than 3 years:** 100 percent of estate.
- **No descendants and married less than 3 years:** 50 percent of estate with remainder to surviving parents, equally, or all of remainder to the survivor. Or, if none, to decedent's brothers and sisters, in equal shares, with the descendants of any deceased brother or sister to take his or her share.
- ***Note:*** Surviving spouse also has rights to certain interests in property similar to dower and curtesy.

No surviving descendants or spouse: To surviving parents equally, or all to the survivor.

Should no other heir be found: The remaining portion of the estate distributes to surviving spouse even if marriage is of less than 3 years. If spouse is deceased, estate distributes to deceased spouse's heirs.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact the Office of State Revenue Administration, P.O. Box 1272, Little Rock, AR 72203;
Phone: 501-682-7089; Web site: `www.state.ar.us` for further information.

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California

Rules of Intestacy

Regarding community and quasi-community property:

Surviving spouse: ½ of decedent's share of community property and ½ of decedent's share of quasi-community property.

Regarding separate property:

Either surviving spouse or domestic partner:

- **If no surviving issue, parent, brother, sister, or issue of a deceased brother or sister:** 100 percent of intestate estate.
- **With only one child or the issue of one deceased child:** ½ of intestate estate.
- **If no issue but a parent or parents or their issue or the issue of either of them:** ½ of intestate estate.
- **If decedent leaves more than one child, one child and the issue of one or more deceased children, or issue of two or more deceased children:** ½ of intestate estate.

No surviving spouse or domestic partner (or portion not distributed to surviving spouse or domestic partner):

- To the issue of the decedent, the issue taking equally if they are all of the same degree of kinship to the decedent, but if of unequal degree those of more remote degree take by right of representation.
- If no surviving issue, to the decedent's parent or parents equally.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact the California State Controller's Office, P.O. Box 942850, Sacramento, CA 94250-5872; Phone: 916-445-2636; Web site: `www.sco.ca.gov` for further information.

Colorado

Rules of Intestacy

Surviving spouse:

- **No descendant or parent of decedent or all of decedent's surviving descendants are also descendants of the surviving spouse and there are no other descendants of the surviving spouse who survive decedent:** All of estate.
- **No descendant but a surviving parent:** First $200,000, plus ¾ of balance of the estate.
- **If all of decedent's surviving descendants are also descendants of the surviving spouse, and the surviving spouse has one or more surviving descendants who are not descendants of decedent or if one or more of decedent's surviving descendants are not descendants of decedent's surviving spouse, and all of such surviving descendants who are children of decedent are adults:** First $100,000 plus ½ of any balance of intestate estate.
- **If one or more of decedent's surviving descendants are not descendants of decedent's surviving spouse, and if one or more of such descendants who are children of decedent are minors:** ½ of estate.

No surviving spouse (or portion not distributed to surviving spouse): Same as Alabama to the point described earlier.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return is required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact the Colorado Department of Revenue, 1375 Sherman St., Denver, CO 80261; Phone: 303-238-7378; Web site: `www.revenue.state.co.us` for further information.

Connecticut

Rules of Intestacy

Surviving spouse:

- **No surviving issue or parents:** All of estate.
- **No issue but surviving parents:** First $100,000 plus ¾ of the balance.
- **With issue, all being issue of the surviving spouse:** First $100,000 plus ½ of the balance of estate.
- **With issue, and one or more aren't issue of surviving spouse:** ½ of estate.

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No surviving spouse (or portion not distributed to surviving spouse):

- To the issue of decedent.
- Moiety, to decedent's parent or parents equally, but none to any parent who has abandoned decedent as a minor child and continued such abandonment until the time of death of such child.

State Estate Taxes: Estates $2 million and less are not subject to tax. Estates over $2 million are taxed on full value of estate, including first $2 million. File **Form CT-706/709** with Department of Revenue Services, P.O. Box 2978, Hartford, CT 06104-2978; Phone: 800-382-9463; Web site: `www.ct.gov/drs/site/default.asp`; due on or before April 15 of the year following the year the gifts were made unless an extension for filing Form CT-706/709 is granted. If the due date falls on a Saturday, Sunday, or legal holiday, the next business day is the due date.

Delaware

Rules of Intestacy

Surviving spouse:

- **No surviving issue or parents:** All of the estate.
- **No surviving issue but survived by a parent or parents or with surviving issue all being issue of the surviving spouse**: First $50,000 of the intestate personal estate, plus ½ of the balance of the personal estate, plus a life estate in the real estate.
- **If there are surviving issue, one or more of whom are not issue of the surviving spouse:** ½ of the personal estate, plus a life estate in the real estate.

No surviving spouse (or portion not distributed to surviving spouse):

- **To the issue of decedent:** Per stirpes.
- **No surviving issue:** To the parent or parents equally.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return is required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact the Division of Revenue, Thomas Collins Building, 540 S. Dupont Hwy, Dover, DE 19901; Phone: 302-577-8214; Web site: `www.revenue.delaware.gov` for further info.

District of Columbia

Rules of Intestacy

Surviving spouse:

- **No surviving issue or parent:** 100 percent of estate.
- **With issue that is also issue of the surviving spouse or domestic partner and there is no other descendant of the surviving spouse or domestic partner:** ⅔ of any balance of the estate.
- **No issue but surviving parent or parents:** ¾ of any balance of estate.
- **If all of decedent's surviving descendants are also descendants of the surviving spouse or domestic partner and the surviving spouse or domestic partner has one or more descendants who are not descendants of decedent or if one or more of decedent's issue are not issue of the surviving spouse or domestic partner:** ½ of estate.

No surviving spouse (or portion not distributed to surviving spouse):

- To decedent's surviving children and the descendants of any deceased child, by right of representation.
- If no surviving child or descendant, equally to father and mother, or survivor.

State Estate Taxes: File **Form F-76** or **F-76EZ** if the gross estate is more than $1 million with the Office of Tax and Revenue, Audit Division, Estate Tax Unit, P.O. Box 556, Washington, DC 20044-0556; Phone: 202-727-4829; Web site: `www.otr.cfo.dc.gov`.

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Florida

Rules of Intestacy

Surviving spouse:

- **No surviving lineal descendant:** All of estate.
- **With surviving lineal descendants, all of whom are also lineal descendants of the surviving spouse:** First $60,000 plus ½ of remaining estate.
- **With surviving lineal descendants, one or more of whom are not lineal descendants of the surviving spouse:** ½ of estate.

No surviving spouse (or portion not distributed to surviving spouse):

- To decedent's surviving children and the descendants of any deceased child, by right of representation.
- To the lineal descendants of decedent, per stirpes, or, if none, to decedent's father and mother equally, or the survivor.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. A personal representative must file **Form DR-312**, affidavit of no Florida tax due, to remove Florida's automatic estate tax lien. Mail to: Florida Department of Revenue, P.O. Box 6460, Tallahassee, FL 32399-6460. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact Florida Department of Revenue, 5050 West Tennessee Street, Tallahassee, FL 32399-0100; Phone: 800-352-3671; Web site: `dor.myflorida.com/dor/` for further information.

Georgia

Rules of Intestacy

Surviving spouse:

- **No descendants:** All of estate.
- **With descendants:** If decedent is survived by any child or other descendant, the spouse shall share equally with the children, with the descendants of any deceased child taking that child's share per stirpes; provided that the spouse's portion shall not be less than a ⅓ share.

No surviving spouse (or portion not distributed to surviving spouse):

- **With descendants:** Estate distributes equally to decedent's children and descendants of any deceased child, with descendants of deceased child taking per stirpes.
- **No descendants:** Surviving parents of decedent share estate equally.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact Georgia Department of Revenue, 1800 Century Center Blvd., Atlanta, GA 30345-3205; Phone: 404-417-4477; Web site: `www.etax.dor.ga.gov` for further information.

Hawaii

Rules of Intestacy

Surviving spouse or reciprocal beneficiary:

- The entire intestate estate if no surviving descendant or parent of decedent, or if all of decedent's descendants are also descendants of surviving spouse or reciprocal beneficiary and no other descendant of surviving spouse or reciprocal beneficiary survives.
- The first $200,000 plus ¾ of any balance of intestate estate if no descendant survives but a parent survives.
- The first $150,000 plus ½ of any balance of intestate estate if all descendants of decedent are also descendants of surviving spouse or reciprocal beneficiary and surviving spouse or reciprocal beneficiary has one or more surviving descendants who are not descendants of decedent.
- The first $100,000 plus ½ of any balance of intestate estate if one or more of decedent's surviving descendants are not descendants of surviving spouse or reciprocal beneficiary.

No surviving spouse (or portion not distributed to surviving spouse):

- **With descendants:** Estate distributes equally to decedent's children and descendants of any deceased child, with descendants of deceased child taking per stirpes.

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- **No descendants:** Surviving parents of decedent share estate equally.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact Taxpayer Services Branch, P.O. Box 259, Honolulu, HI 96809-0259; Phone: 800-222-3229; Web site: `www.hawaii.gov` for further information.

Idaho

Rules of Intestacy

Surviving spouse:

- **No issue or surviving parents:** 100 percent of separate property and decedent's 50 percent of community property.
- **With issue or no issue and surviving parents:** 50 percent of separate property and decedent's 50 percent of community property.

No surviving spouse (or portion not distributed to surviving spouse): Same as Alabama to the point described earlier.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact Idaho State Tax Commission, P.O. Box 36, Boise, ID 83722-0410; Phone: 800-972-7660; Web site: `www.tax.idaho.gov` for further information.

Illinois

Rules of Intestacy

Surviving spouse:

- **No descendants:** All of estate.
- **With descendants:** ½ of estate.

No surviving spouse (or portion not distributed to surviving spouse):

- **With descendants:** To decedent's descendants, per stirpes.
- **No descendants:** To the parents, brothers, and sisters of decedent in equal parts, allowing to the surviving parent if one is dead a double portion and to the descendants of a deceased brother or sister per stirpes the portion which the deceased brother or sister would have taken if living.

State Estate Taxes: For decedents with a date of death after December 31, 2005, but prior to January 1, 2010, and an estate exceeding $2 million, file **Form 700** with county treasury and attorney general's office within nine months of death. For Cook, DuPage, Lake, and McHenry Counties, the attorney general's copy, along with a copy of the federal return, are filed at Office of the Attorney General, Revenue Litigation Bureau – Estate Tax Section, 100 West Randolph Street, 13th Floor, Chicago, IL 60601. For all other counties, the attorney general's copy, along with a copy of the federal return, are filed at Office of the Attorney General, Revenue Litigation Bureau – Estate Tax Section, 500 South Second Street, Springfield, IL 62706. Payment of all taxes, penalty, and interest are made to the county treasurer. For the year 2011, Illinois won't have an estate tax. For dates of death prior to January 1, 2005, please contact Illinois Attorney General, 100 West Randolph St., Chicago, IL 60601; Phone: 312-814-3000; Web site: `www.ag.state.il.us` for specific information.

Indiana

Rules of Intestacy

Surviving spouse:

- **No issue or surviving parents:** All of estate.
- **No issue but one or both surviving parents:** ¾ of estate.
- **With at least one child or issue of a deceased child:** ½ of estate.
- If the surviving spouse is a second or other subsequent spouse who did not at any time have children by decedent, and decedent left surviving a child or the descendants of a child or children by a previous spouse, the surviving second or subsequent childless spouse shall take only an amount equal to ¼ of the remainder of the fair market value as of the date of death of the real property of the decedent minus the value of the liens and encumbrances on the real property

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of the decedent. However, a second or subsequent surviving spouse receives the same share of personal property of decedent as surviving spouses generally, as described above.

No surviving spouse (or portion not distributed to surviving spouse):

- To issue, equally if they are all of same degree of kinship. Those of unequal degree take by representation.
- If there is a surviving spouse but no issue, to decedent's surviving parents. If no surviving spouse or issue, to surviving parents, brothers and sisters, and issue of deceased brothers and sisters by representation. Each living parent shall be treated as of the same degree as brothers and sisters, except that the share of each parent shall not be less than ¼ of the net estate.

State Estate Taxes: File **Form IH-6** with Indiana Department of Revenue, P.O. Box 71, Indianapolis, IN 46206-0071 within nine months. Contact the Indiana Department of Revenue, 100 N. Senate Ave., Indianapolis, IN 46204; Phone: 317-232-2240; Web site: `www.in.gov/dor/index.htm` for further information.

Iowa

Rules of Intestacy

Surviving spouse:

- **No issue or issue is also that of surviving spouse:** All of estate.
- **With issue that isn't issue of surviving spouse:** ½ of estate.

No surviving spouse (or portion not distributed to surviving spouse): Same as Alabama to the point described earlier.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact Iowa Department of Revenue, P.O. Box 10460, Des Moines, IA 50306-0460; Phone: 515-281-3114; Web site: `www.state.ia.us/tax/index.htm` for further information.

Kansas

Rules of Intestacy

Surviving spouse:

- **No children or issue of a predeceased child:** All of estate.
- **With child or children or issue of a predeceased child:** ½ of estate.
- **In either case:** Under certain conditions, ½ of all real estate which decedent owned at any time during the marriage as to which surviving spouse didn't consent to disposition.

No surviving spouse (or portion not distributed to surviving spouse): Same as Alabama, to the point described earlier.

State Estate Taxes: File **Form K-706** if the estate is greater than $1 million. Mail to Kansas Department of Revenue, Customer Relations-Estate Tax, 915 SW Harrison St., Topeka, KS 66625-2222. Estates of decedents dying after 2009 are not subject to the Kansas estate tax.

Kentucky

Rules of Intestacy

Surviving spouse: Personal property or cash in the amount of $15,000, and ½ of each piece of real estate owned by decedent or for his or her benefit at time of death, and an estate for life in ½ of all real estate owned by the decedent during the marriage but no longer owned, unless the surviving spouse had relinquished this right, and ½ of decedent's personalty. If no children or their descendants or parents of decedent, the whole estate goes to the surviving spouse.

No surviving spouse (or portion not distributed to surviving spouse):

- To children and their descendants.
- **No children or descendants:** To parents, if both are living, equally. If one parent is dead, the other, if living, shall take the whole estate.
- **If none of the above:** To the surviving spouse.

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State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact Kentucky Department of Revenue, Frankfort, KY 40602; Phone: 502-564-4581; Web site: `www.revenue.ky.gov` for further information.

Louisiana

Rules of Intestacy

Community (Marital) Property: If decedent leaves no descendants, the surviving spouse succeeds to decedent's share of community property. If descendants survive decedent, the surviving spouse has a usufruct over (right to use) decedent's share of community property for life or until remarriage (whichever occurs first), after which the descendants succeed to that share of the community property. If no descendants, to brothers and sisters with usufruct to surviving parents, or, if none, to nieces or nephews or their descendants, with usufruct to decedent's surviving parents.

Separate (Nonmarital) Property: Decedent's descendants succeed to decedent's separate property. If decedent leaves no descendants but is survived by one parent, or both, and by a brother or sister, or both, or descendants from them, the brothers and sisters or their descendants succeed to the separate property of decedent, subject to a usufruct in favor of the surviving parent or parents. If both parents survive decedent, the usufruct is joint and successive. If decedent leaves neither descendants nor parents, decedent's brothers and sisters or descendants from them succeed to his separate property. Or, if none, to decedent's surviving parents, or, if none, to decedent's surviving spouse.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact Louisiana Department of Revenue, P.O. Box 201, Baton Rouge, LA 70821; Phone: 225-219-0067; Web site: `www.rev.state.la.us` for more information.

Maine

Rules of Intestacy

Surviving spouse or registered domestic partner:

- **No surviving issue or parent of decedent:** All of estate.
- **No surviving issue but surviving parent or parents, or surviving issue all of whom are issue of the surviving spouse or surviving registered domestic partner:** The first $50,000, plus ½ of the balance of the estate.
- **With surviving issue, one or more of whom are not issue of the surviving spouse or surviving registered domestic partner:** ½ of estate.

No surviving spouse or registered domestic partner (or portion not distributed to such person): Same as Alabama to the point described earlier.

State Estate Taxes: File **Form 706ME** for estates greater than $1 million and mail to Maine Revenue Services, Income/Estate Tax Division, P.O. Box 1068, Augusta, ME 04332-1068. Estates less than $1 million must file **706ME-EZ** to request the release of the automatic statutory estate tax lien on real or tangible personal property for estates with no tax liability. For further info, contact Maine Revenue Services at 207-626-8480 or Web site: `www.maine.gov/revenue/rules`.

Maryland

Rules of Intestacy

Surviving spouse:

- **No surviving issue or parent:** All of estate.
- **With surviving minor child:** ½ of estate
- **Surviving minor child, but surviving issue or surviving parent:** First $15,000 plus ½ of the remainder.

No surviving spouse (or portion not distributed to surviving spouse): Same as Alabama to the point described earlier.

State Estate Taxes: Complete **Form 706** first before filing the Maryland estate tax return. If no Form 706 is required, you must still complete

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a pro forma federal return in order to complete Maryland estate tax return, **Form MET-1**. Form MET-1 must be filed with the Register of Wills office for the county in which the estate is being administered within nine months of date of death. Mail to Revenue Administration Division, P.O. Box 828, Annapolis, MD 21404-0828. For further information, contact the Revenue Administration Division at 800-MD TAXES or Web site: `www.marylandtaxes.com`.

Massachusetts

Rules of Intestacy

Surviving spouse:

- **No issue and no kindred:** All of estate.
- **With issue:** ½ of personal property and ½ of real property to surviving spouse, remaining ½ to issue, by right of representation.
- **No issue, but kindred:** First $200,000 plus ½ of remaining personal property and ½ of remaining real property with remainder to kindred.

No surviving spouse (or portion not distributed to surviving spouse):

- **No surviving spouse, but surviving children or issue of a deceased child:** In equal shares to children and issue of deceased children by right of representation.
- **No surviving spouse or children or issue of a deceased child, but surviving parents:** To surviving parents, equally, or all to the survivor.

State Estate Taxes: Decoupled from federal estate tax for deaths occurring on or after January 1, 2003. For deaths on or after January 1, 2006, first $1 million of gross estate (including adjusted gifts) is excludable for estate tax purposes. File **Form M-706** with Massachusetts Estate Tax Unit, P.O. Box 7023, Boston, MA 02204 within nine months after date of death.

Michigan

Rules of Intestacy

Surviving spouse:

- **No surviving descendant or parent:** All of estate.
- **No descendants but surviving parents:** The first $150,000, plus ¾ of any balance of the intestate estate.
- **If all descendants are also descendants of the surviving spouse:** The first $150,000 plus ½ of any balance of the estate.
- **If all of the decedent's surviving descendants are also descendants of the surviving spouse and the surviving spouse has one or more surviving descendants who are not descendants of the decedent or, if one or more, but not all, of the decedent's surviving descendants are not descendants of the surviving spouse:** First $150,000, plus ½ of any balance of the estate.
- **If none of the decedent's surviving descendants are descendants of the surviving spouse:** First $100,000, plus ½ of any balance of the estate.

No surviving spouse (or portion not distributed to surviving spouse): Same as Alabama, to the extent described earlier, but substitute "descendant" for "issue" wherever it appears in this regard.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact Michigan Department of Treasury, Lansing, MI 48922; Phone: 517-373-3200; Web site: `www.michigan.gov/treasury` for more information.

Minnesota

Rules of Intestacy

Surviving spouse:

- **No issue or all issue are also issue of the surviving spouse and there is no other descendant of the surviving spouse who survives the decedent:** All of estate.
- **Surviving spouse has one or more surviving descendants who are not descendants of the decedent, or one or more of decedents surviving descendants are not also descendants of the surviving spouse:** First $150,000, plus ½ of any balance of the estate.

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No surviving spouse (or portion not distributed to surviving spouse): To decedent's descendants by representation, or, if none, to decedent's parents equally or all to the survivor.

State Estate Taxes: File **Form M706** for estates greater than $1 million and mail to Minnesota Revenue, Mail Station 1315, St. Paul, MN 55146-1315 within nine months of date of death. For more information, contact Minnesota Revenue Department at 651-296-3475 or www.taxes.state.mn.us.

Mississippi

Rules of Intestacy

Surviving spouse:

- **No descendants:** All of estate.
- **With descendants:** Surviving spouse shares equally with decedent's children of that or a prior marriage, and descendants of a deceased child or children take that child's share,

No surviving spouse (or portion not distributed to surviving spouse): To decedent's descendants by right of representation, or, if none, to the brothers and sisters and father and mother of decedent, and descendants of deceased brothers and sisters, by right of representation.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact Mississippi State Tax Commission, P.O. Box 1033, Jackson, MS 39215-1033; Phone: 601-923-7175; Web site: www.mstc.state.ms.us for further information.

Missouri

Rules of Intestacy

Surviving spouse:

- **No surviving issue:** All of estate.
- **With issue, all of whom are also issue of the surviving spouse:** The first $20,000 of estate, plus ½ of the balance of estate.
- **With issue, one or more of whom are not issue of the surviving spouse:** ½ of estate.

No surviving spouse (or portion not distributed to surviving spouse): Same as Mississippi to the extent described earlier.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact Estate Tax Division, P.O. Box 27, Jefferson City, MO 65105-0027; Phone: 573-751-1467; Web site: www.dor.mo.gov for further information.

Montana

Rules of Intestacy

Surviving spouse: Same as Alaska.

No surviving spouse (or portion not distributed to surviving spouse): Same as Alabama.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact Montana Department of Revenue, P.O. Box 5805, Helena, MT 59604; Phone: 866-859-2254; Web site: www.mt.gov/revenue/default.asp for more information.

Nebraska

Rules of Intestacy

Surviving spouse:

- **If no surviving issue or parent:** All of the estate.
- **If no surviving issue but parent or parents:** First $50,000 plus ½ of the balance of the estate.

No surviving spouse (or portion not distributed to surviving spouse): Same as Alabama.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact Nebraska State Office Building, P.O. Box 94818, Lincoln, NE 68509-4818;

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Phone: 402471-5789; Web site: www.revenue.ne.gov/individual/individual.htm for further information.

Nevada

Rules of Intestacy: All community property goes to the surviving spouse and is his or her sole separate property including community property held with right of survivorship, which vests in accordance with the right of survivorship.

Surviving spouse:

- **No issue, father, mother, brother, sister, or children of any issue:** All of estate.
- **No issue but surviving parents:** ½ to surviving spouse, ¼ to each surviving parent. If only one surviving parent, ½ of estate to that surviving parent.
- **No issue or surviving parents but surviving siblings:** ½ to surviving spouse and remainder equally to brothers and sisters of decedent.
- **With one child or that child's issue:** ½ to surviving spouse and ½ to child or among deceased child's issue.
- **With more than one child or a child and the lawful issue of a deceased child:** ⅓ to surviving spouse and remainder to children in equal shares, with issue of deceased child to take by right of representation.

No surviving spouse (or portion not distributed to surviving spouse): Like Massachusetts, to the extent described earlier.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return is required for the State of Nevada. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact Nevada Department of Taxation, 1550 College Parkway, Carson City, NV 89706; Phone: 775-684-2000; Web site: www.tax.state.nv.us for further information.

New Hampshire

Rules of Intestacy

Surviving spouse:

- **No surviving issue or parent of the decedent:** All of the estate.
- **With issue, all of whom are issue of the surviving spouse and there are no other issue of the surviving spouse who survive the decedent:** First $250,000, plus ½ of the balance.
- **No surviving issue but a parent or parents:** First $250,000, plus ¾ of the balance of the estate.
- **With issue, all of whom are issue of the surviving spouse, and the surviving spouse has one or more surviving issue who are not the issue of the decedent:** First $150,000, plus ½ of the balance of the estate.
- **With surviving issue, one or more of whom are not issue of the surviving spouse:** First $100,000, plus ½ of the balance of the estate.

No surviving spouse (or portion not distributed to surviving spouse): Same as Massachusetts to the extent described earlier.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact Department of Revenue Administration, 45 Chenell Dr., Concord, NH 03301 Phone: 603-271-2191 Web site: www.nh.gov/revenue/index.htm for further information.

New Jersey

Rules of Intestacy

Surviving spouse or domestic partner:

- **No descendant or surviving parent of the decedent or with descendants that are also descendants of the surviving spouse or domestic partner and there**

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is no other descendant of the surviving spouse or domestic partner who survives the decedent: All of estate.

- **No descendants but a surviving parent:** First 25 percent of the estate (not less than $50,000 nor more than $200,000) plus ¾ of any balance remaining.
- **With descendants that are also descendants of the surviving spouse or domestic partner and the surviving spouse or domestic partner has one or more surviving descendants who are not descendants of the decedent or with descendants that are not descendants of the surviving spouse or domestic partner:** First ¼ of the estate, but not less than $50,000 nor more than $200,000, plus ½ of the balance remaining.

No surviving spouse or domestic partner (or portion not distributed to surviving spouse): To the descendants by right of representation, or if none, to the parents equally, or the survivor of them.

State Estate Taxes: File **Form IT-Estate (12-07)** and mail to Transfer Inheritance Tax, P.O. Box 249, Trenton, NJ 08695-0249. For further information contact the New Jersey Revenue Division at 609-826-4400 or `www.state.nj.us/treasury/taxation`.

New Mexico

Rules of Intestacy

Surviving spouse:

- **With issue:** 25 percent of separate property and 50 percent of decedent's community property.
- **No issue:** All of estate.

No surviving spouse (or portion not distributed to surviving spouse): Same as Alabama to the point described earlier.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact Taxation & Revenue Department, P.O. Box 630, Santa Fe, NM 87504-0630; Phone: 505-827-0700; Web site: `www.tax.state.nm.us` for further information.

New York

Rules of Intestacy

Surviving spouse:

- **With issue:** First $50,000 plus ½ of the remaining balance.
- **No issue:** All of estate.

No surviving spouse (or portion not distributed to surviving spouse): Same as Alabama to the point described earlier.

State Estate Taxes: For decedents dying on or after January 1, 2004, and the estate is greater than $1 million, file **Form ET-706** within nine months of the decedent's date of death. For decedents dying after February 1, 2000, and before January 1, 2004, and if the estate was required to file a federal estate tax return then Form ET-706 must be filed. Send it to NYS Estate Tax, Processing Center, P.O. Box 15167, Albany, NY 12212-5167.

North Carolina

Rules of Intestacy

Surviving spouse:

- **No issue or surviving parents:** All of real and personal property.
- **No issue but surviving parents:** ½ of real property and $50,000 plus one half of the balance of the personal property
- **With only one child or his or her descendants:** ½ of real property and $30,000 plus ½ of the balance of the personal property.
- **With more than one child or descendants of a deceased child:** ⅓ of real property and $30,000 plus ⅓ of the balance of the personal property.

No surviving spouse (or portion not distributed to surviving spouse): Same as Alabama to the point described above.

State Estate Taxes: For decedents dying on or after January 1, 2005, the North Carolina estate tax will continue to be equal to the state death tax credit that was allowable under section 2011 of the Internal Revenue Code, as it existed prior to 2002. File **Form A-101** within nine months of date of death and mail to North Carolina Department of Revenue, P.O. Box 25000, Raleigh, NC 27640-0100. For decedents dying

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prior to January 1, 2005, contact North Carolina Department of Revenue, P.O. Box 25000, Raleigh, NC 27640-0640; Phone: 877-252-3052; Web site: www.dor.state.nc.us/index.html for further information.

North Dakota

Rules of Intestacy

Surviving spouse:

- **With no issue or parent or all of the decedent's surviving descendants are also descendants of the surviving spouse:** All of estate.
- **With no issue but a surviving parent:** First $200,000 plus ¾ of any balance of the intestate estate.
- **With issue that is also the issue of the surviving spouse and the surviving spouse has one or more surviving descendants who are not descendants of the decedent:** First $150,000 plus ½ of any balance of the intestate estate.
- **With issue that isn't a descendant of the surviving spouse:** First $100,000 plus ½ of any balance of the intestate estate.

No surviving spouse (or portion not distributed to surviving spouse): Same as Alabama to the point described earlier.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact Office of State Tax Commissioner, 600 E Boulevard Ave., Dept 127, Bismarck, ND 58505-0599; Phone: 701-328-2770; Web site: www.nd.gov/tax for further information.

Ohio

Rules of Intestacy

Surviving spouse:

- **No lineal descendants or with children or their descendants who are also descendants of the surviving spouse:** All of estate.
- **If there is one child of the decedent or the child's lineal descendants surviving and the surviving spouse is not the natural or adoptive parent of the decedent's child:** First $20,000 plus ½ of the balance.
- **If there are more than one child or their lineal descendants surviving if the spouse is the natural or adoptive parent of one, but not all, of the children:** First $60,000, or the first $20,000 if the spouse is the natural or adoptive parent of none of the children, plus ½ of the balance of the estate.

No surviving spouse (or portion not distributed to surviving spouse): Same as Massachusetts to the point described earlier.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact Tax Commissioner Office, 30 E. Broad St., 22nd Floor, Columbus, OH 43215; Phone: 800-977-7711; Web site: www.tax.ohio.gov for further information.

Oklahoma

Rules of Intestacy

Surviving spouse:

- In any event, complete ownership of a car owned by the decedent.
- **No surviving issue, parents or siblings:** All of estate.
- **No surviving issue but is survived by parents or siblings:** All of the property acquired by the joint industry of the husband and wife during *coverture* (the state of a married woman), and an undivided ⅓ interest in the remaining estate.
- **With issue, all of whom are also issue of the surviving spouse:** An undivided ½ interest in all intestate property however acquired.
- **With issue, one or more of whom are not also issue of the surviving spouse:** An undivided ½ interest in the property acquired by the joint industry of the husband and wife during coverture, and an undivided equal part in the property of the decedent not acquired by the joint industry of the husband and wife during coverture with each of the living children of the decedent and

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the lawful issue of any deceased child by right of representation.

No surviving spouse (or portion not distributed to surviving spouse): Same as Alabama to the point described earlier.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact Oklahoma Tax Commission, Estate Tax Department, 2501 N. Lincoln Blvd, Oklahoma City, OK 73194; Phone: 405-521-3160; Web site: `www.oktax.state.ok.us` for further information.

Oregon

Rules of Intestacy

Surviving spouse:

- **No issue or with issue, all of whom are issue of the surviving spouse:** All of estate
- **With issue, and one or more are not issue of the surviving spouse:** ½ of estate.

No surviving spouse (or portion not distributed to surviving spouse): Same as Massachusetts to the point described earlier.

State Estate Taxes: For estates valuing greater than $1 million, file **Form IT-1, Oregon Inheritance Tax Form,** and mail to Oregon Department of Revenue, P.O. Box 14110, Salem, OR 97309-0910. If you need further information, contact the Oregon Department of Revenue, 955 Center St., NE Salem, OR 97301; Phone: 503-378-4988; Web site: `www.oregon.gov/DOR`.

Pennsylvania

Rules of Intestacy

Surviving spouse:

- **No surviving issue or parent(s):** All of the estate.
- **No surviving issue but is survived by a parent(s) or with issue, all of whom are issue of the surviving spouse:** First $30,000 plus ½ of the balance of the estate.
- Notwithstanding the foregoing, in the case of a decedent who died as a result of the terrorist attacks of September 11, 2001, a surviving spouse is entitled to 100 per cent of any compensation award paid pursuant to the Air Transportation Safety and System Stabilization Act (Public Law 107-42, 115 Stat. 230).
- **With issue, one or more of whom are not issue of the surviving spouse:** ½ of the estate.
- In case of partial Intestacy, any property received by the surviving spouse under the will shall go toward satisfying the $30,000 allowance mentioned earlier.

No surviving spouse (or portion not distributed to surviving spouse): Same as Massachusetts to point described earlier.

State Estate Taxes: File **Form REV-1500, Pennsylvania Inheritance Tax Return** within nine months of date of death. The return is to be filed in duplicate, with the Register of Wills of the county in which the decedent was a resident at the time of death. For a list of Register of Wills, contact PA Department of Revenue, Bureau of Individual Taxes, P.O. Box 280601, Harrisburg, PA 17128-0601; Phone: 800-362-2050; Web site: `www.revenue.state.pa.us`.

Rhode Island

Rules of Intestacy

Surviving spouse:

- **Re personal property:**

  No issue: $50,000 and ½ of remaining estate.

  With issue: ½ of estate.

- **Re real estate:**

  A life estate in all real estate held in decedent's name alone, or alternatively, probate court may allow surviving spouse to fully own real estate located in Rhode Island and valued at $75,000 or less, or, if the property is worth more, the Court may order the sale of property with surviving spouse to get $75,000 of sale proceeds.

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No surviving spouse (or portion not distributed to surviving spouse): Same as Massachusetts to point described earlier.

State Estate Taxes: For a decedent dying on or after January 1, 1992, file **Form 100, Rhode Island Estate Tax Return**. For a decedent dying prior to January 1, 1992, **Form RI-706** should be filed. The return, with payment, is due within nine months of the date of death. Mail to Rhode Island Division of Taxation, Estate Tax Section, One Capitol Hill, Providence, RI 02908. You can contact the division of taxation at this address, call 401-574-8900, or visit its Web site at `www.tax.state.ri.us` for more information.

South Carolina

Rules of Intestacy

Surviving spouse:

- **No issue:** All of the intestate estate, including the decedent's ½ of community property.
- **With issue:** ½ of the intestate estate.

No surviving spouse (or portion not distributed to surviving spouse): Same as Massachusetts to the point described earlier. But note that the share of any parent who failed reasonably to provide for the decedent during minority can be reduced or eliminated by the probate court.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact the South Carolina Department of Revenue, 3 South Park Circle, Suite 202, Charleston, SC 29407; Phone: 843-852-3600; Web site: `www.sctax.org` for further information.

South Dakota

Rules of Intestacy

Surviving spouse:

- No descendant or all of the descendants are also descendants of the surviving spouse: All of the estate.
- If one or more of the decedent's surviving descendants are not descendants of the surviving spouse: First $100,000, plus ½ of any balance of the estate.

No surviving spouse (or portion not distributed to surviving spouse): Same as Massachusetts to the extent described earlier.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact South Dakota Department of Revenue, 445 East Capitol Avenue, Pierre, SD 57501-3185; Phone: 605-773-3311; Web site: `www.state.sd.us` for further information.

Tennessee

Rules of Intestacy

Surviving spouse:

- **No surviving issue:** All of the intestate estate, including the decedent's ½ of community property.
- **With surviving issue:** Either ⅓ or a child's share of the entire intestate estate, whichever is greater.

No surviving spouse (or portion not distributed to surviving spouse): Same as Massachusetts to the point described earlier.

State Estate Taxes: File **Form INH 301, Tennessee Inheritance Tax Return,** within nine months of date of death and mail to Tennessee Department of Revenue, Andrew Jackson State Office Building, 500 Deadrick St., Nashville, TN 37242-0600. You may contact the department of revenue at the above address; call 615-532-6400; or visit `www.state.tn.us` if you have further questions.

Texas

Rules of Intestacy

Surviving spouse:

- **Re community property:**

  No surviving descendants or descendants all of whom are also descendants of surviving spouse: All community property.

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Surviving descendants, not all of whom are descendants of surviving spouse: Surviving spouse gets only his or her own ½ share of community property.

- **Re separate property:**

  No surviving descendants: All of personal estate and ½ of real estate, or all of real estate if the deceased has neither surviving father nor mother nor surviving brothers or sisters, or their descendants.

  With surviving descendants: ⅓ of entire estate with remainder equally to children or their descendants.

No surviving spouse (or portion not distributed to surviving spouse):

- **Descendants:** All of the estate.
- **No descendants:** Parents of the decedent, equally. If only one parent survives, estate to be divided into two equal portions, one of which shall pass to such survivor, and the other half shall pass to the brothers and sisters of the deceased, and to their descendants, but if there be none, then the whole estate shall be inherited by the surviving father or mother.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact the Texas Department of Taxes, 16630 Imperial Valley Drive, Suite 227, Houston, TX 77060-3411; Phone: 800-531-5441; Web site: `www.window.state.tx.us` for further information.

Utah

Rules of Intestacy

Surviving spouse:

- **No descendants or all of the decedent's surviving descendants are also descendants of the surviving spouse:** All of the estate.
- **If one or more of decedent's surviving descendants are not descendants of surviving spouse:** First $50,000, plus ½ of any balance of estate.

No surviving spouse (or portion not distributed to surviving spouse): Same as Massachusetts to the extent described earlier.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact Utah State Tax Commission, 210 North 1950 West, Salt Lake City, UT 84134; Phone: 800-662-4335; Web site: `www.tax.utah.gov` for further information.

Vermont

Rules of Intestacy

Surviving spouse:

- All articles of wearing apparel and ornament, the wearing apparel of the decedent, and such other part of the personal estate of the decedent as the probate court assigns to the surviving spouse, according to his or her circumstances and the estate and degree of the decedent, which shall not be less than ⅓, after the payment of the debts, funeral charges and expenses of administration.
- ⅓ in value of all the real estate, but if there is only one heir and such heir is the issue of the widow or the heir by adoption of the widow and husband, surviving spouse shall be entitled to ½ the value of such real estate.
- No issue and the surviving spouse does not elect to take ⅓ in value of real estate of which the decendent dies seized in his or her own right, or waives the provisions of the will of such decedent, such spouse shall be entitled to whole of decedent's estate forever, if it does not exceed $25,000; if it exceeds that sum, then such spouse shall be entitled to $25,000 and ½ the remainder. The remainder of such estate shall descend as the whole would if such spouse did not survive. If the decedent has no kindred who may inherit estate, such spouse shall be entitled to the whole of such estate.

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No surviving spouse (or portion no distributed to surviving spouse):

- **With issue:** Equal shares to children or the legal representative of deceased children.
- **With no issue:** In equal shares to the father and mother or the survivor.

State Estate Taxes: File **Form E-1, Vermont Estate Tax Return,** within nine months of date of death and mail to Vermont Department of Taxes, 133 State Street, Montpelier, VT 05633-1401. You may contact Vermont Department of Taxes at the above address; call 802-828-2548; or visit `vermont.gov/portal/` for more information.

Virginia

Rules of Intestacy

Surviving spouse:

- **No issue or issue is also that of the surviving spouse:** All of estate.
- **With issue, one or more of whom are not issue of the surviving spouse:** ⅓ of estate.

No surviving spouse (or portion not distributing to surviving spouse): Same as Massachusetts, to the point described earlier.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact Virginia Department of Taxation, Office of Customer Services, P.O. Box 1115, Richmond, VA 23218-1115; Phone: 804-367-8031; Web site: `www.tax.virginia.gov` for more information.

Washington

Rules of Intestacy

Surviving spouse:

- **No surviving issue, parents, or issue of decedent's parents:** All of net community and separate estate.
- **With issue:** All of decedent's share of net community estate and ½ of the net separate estate.
- **No surviving issue, but is survived by one or more parents or one or more issue of one or more of decedent's parents:** All of decedent's share of net community estate and ¾ of the net separate estate.

No surviving spouse (or portion not distributed to surviving spouse): Same as Massachusetts to the point described earlier.

State Estate Taxes: File a Washington State Estate and Transfer Tax Return within nine monthsof date of death, making sure that the proper year's form is used depending on date of death. One is for dates of death on or after May 7, 2005, and the other is for prior to May 17, 2005. Mail to Washington State Department of Revenue, P.O. Box 47488, Olympia, WA 98504-7488. For further information contact the Washington State Department of Taxes at the above address; call 800-647-7706; or visit them on the Web at `www.dor.wa.gov`.

West Virginia

Rules of Intestacy

Surviving spouse:

- **No descendants or all of the descendants are also descendants of the surviving spouse and there is no other descendant of the surviving spouse:** All of estate.
- **If all of the decedent's surviving descendants are also descendants of the surviving spouse and the surviving spouse has one or more surviving descendants who are not descendants of the decedent:** ⅔ of estate.
- **If one or more of the decedent's surviving descendants are not descendants of the surviving spouse:** ½ of the estate.

No surviving spouse (or portion not distributed to surviving spouse): Same as Massachusetts to the point described earlier.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact Revenue Division,

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P.O. Box 2389, Charleston, WV 25328-2389; Phone: 800-422-2075; Web site: www.wv.gov for further information.

Wisconsin

Rules of Intestacy

Surviving spouse:

- **No surviving issue, or if the surviving issue are all issue of the surviving spouse:** All of the estate.
- **With issue, one or more of whom are not issue of the surviving spouse:** ½ of decedent's property other than the following property:
  a. The decedent's interest in marital property
  b. The decedent's interest in property held equally and exclusively with the surviving spouse as tenants in common.

No surviving spouse (or portion not distributed to surviving spouse): Same as Massachusetts to the point described earlier.

State Estate Taxes: For deaths occurring after September 30, 2002 and before January 1, 2008, **Form W706** must be filed for every decedent whose gross estate, plus adjusted taxable gifts and specific exemption is $675,000 or more. For deaths occurring after December 31, 1992, and before October 1, 2002, **Form W706** must be filed for every estate that had a requirement to file a federal estate tax return **(Form 706).** There is no Wisconsin estate tax for deaths occurring on or after January 1, 2008. For further information contact the Wisconsin Department of Revenue, P.O. Box 8904, Madison, WI 53708-8904; Phone: 608-266-2772; Web site: www.revenue.wi.gov.

Wyoming

Rules of Intestacy

Surviving spouse:

- **No children or descendants of children:** All of estate.
- **With children or descendants of children:** ½ of estate.

No surviving spouse (or portion not distributed to surviving spouse):

- **With children or descendants of children:** In equal shares, by right of representation.
- **With no children or descendants of children:** To decedent's surviving father, mother, brothers, sisters, and the descendants of a deceased brother or sister by right or representation, in equal parts.

State Estate Taxes: Decedents dying after December 31, 2004, and before January 1, 2011, no estate tax return required. For decedents dying prior to January 1, 2005, or after December 31, 2010, contact Estate Tax Administrator, 122 West Twenty-fifth Street, Herschler Building, Cheyenne, WY 82002-0110; Phone: 307-777-5200; Web site: revenue.state.wy.us for more information.

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